Practical Problems in Banking and Currency

BEING A NUMBER OF SELECTED ADDRESSES DELIVERED IN RECENT YEARS BY PROMINENT BANKERS, FINANCIERS AND ECONOMISTS

Edited by

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With an Introduction by the

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of New York

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PREFACE

A FEW months ago the editor had occasion to investigate several addresses delivered by prominent bankers and economists, and as an outgrowth of this study he decided to compile a number of the more important and valuable of these into book form, believing such a work to be a significant addition to banking literature. He was further encouraged in this work by the assurance of both bankers and educators that such a compilation would be welcomed as a reference book in connection with studies in banking and currency.

That the bankers' associations of this country have accomplished much that is praiseworthy from an educational view-point remains unquestioned. Their annual conventions have been devoted to the discussion of practical problems as they affect actual conditions. If the currency question, the trust company controversy, or any other vital topic was confronting the general banking situation, it was sure to receive consideration at some bankers' convention by an able authority, trained through years of experience. As a result we find association proceedings containing many excellent papers treating subjects that standard works on banking have either omitted or inadequately handled.

The addresses contained in this volume cover the period since 1900. The years since that date have been remarkable for several reasons. First, the perennial currency agitation has made several strides, that is, as far as the discussion of the subject is concerned. The controversy over asset currency and branch banking has attained prominence that previously had not been achieved. During the years 1902 and 1903 this contention was at its height, and many practical bankers and students of finance undertook a solution of the question. The lull in the discussion following these two years was only temporary, as the question was revived in 1906, and such organizations as the New York Chamber of Commerce and

the American Bankers' Association diligently sought a remedy for the monetary evil.

Second, the rise to prominence of the trust company as a factor in finance created considerable discussion both from a positive and negative view-point. With the popularizing of this form of banking naturally came the accompanying problems. Many difficulties that never had menaced the commercial or savings bank were left to the trust company for solution. That this form of banking is here to stay no one now questions. Its advantages are its freedom and magnitude of scope, characteristics not possessed to the same extent by commercial or savings banks.

In selecting the papers to be contained in this volume the editor deemed it prudent in several instances to choose more than one address on the same subject, believing that the reader should be given an opportunity of understanding the various opinions maintained by the leading authorities. Especially is this true of the discussions on elastic currency, branch banking, bank supervision and one or two additional topics. Questions like the foregoing of vital moment to both the banking interests and the commercial world can be solved only after considerable examination and sifting on the part of capable and experienced men.

It has been a source of deep regret to the editor that the size of the volume limits the number of addresses to be contained herein. There are many papers, carefully prepared, thorough, lucid and specialized on some important topic, that are omitted merely on account of the fact that the volume was severely crowded for space. Some of the papers originally requested for publication have been omitted also for this reason. If, however, there appears a sufficient demand on the part of those interested in this branch of commerce, it is hoped that the conditions will be favorable for the publication of a second volume, by means of which a large mass of valuable material may be brought into accessible form for the banker or student of finance.

The editor is especially indebted for valuable assistance and timely suggestions to Professor Herbert J. Davenport of the University of Chicago and to the Honorable Charles G. Dawes, ex-Comptroller of the Currency and President of the Central Trust Company of Illinois, Chicago. To the Honorable Charles Francis

Phillips of New York City, the editor wishes to acknowledge his thorough appreciation for contributing, in addition to his address, the Introduction. President S. R. Flynn of the National Live Stock Bank of Chicago and Dr. Robert Morris of the University of Chicago were both indulgent in giving aid and encouragement at the time the volume was first contemplated. To the contributors as a body the editor feels deeply indebted for their courtesy and willingness in giving their time and offering ideas that made the compilation of the volume a much easier task.

WALTER HENRY HULL, Editor.

The University of Chicago
December, 1906

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INTRODUCTION

THIS introduction is not designed to be a commentary on the many important and highly interesting articles of which the present volume is composed; but rather a brief exposition of the purpose which has prompted their publication, and a suggestion of the benefits to be derived from a careful study of the conditions which they undertake to describe and to analyze, or to which they necessarily direct attention.

The authors of these articles are all men of experience, many of them distinguished by abilities and achievements which have gained for them national, and even international, reputation. They are all both thinkers and workers, accustomed alike to solve the problems of the day and to govern the enterprises with which those problems are associated. They speak with authority; and the habits of prompt determination, precise action, and watchful and energetic management, which have become their mode of life, lead them to write with a clearness and a conciseness which make it easy to grasp the ideas they enunciate and to understand and apply the lessons they desire to teach. We may, therefore, very properly allow their work to speak for itself, being assured that it will meet the attention and respect to which it is entitled. Moreover, in regard to both theory and practice, it covers so wide a field of observation, discusses so many matters of present moment, and offers so much sound and pertinent advice, that it cannot fail to be valuable and engaging from whatever point of view it may be regarded.

But, although convinced that the volume now going forth to the public will be sincerely welcomed by a large number of alert and intelligent readers, and will be profitably studied and advantageously discussed by them, we yet deem it a duty on our part to dwell briefly, in these prefatory pages, upon the urgency, and even the necessity, of a very serious and comprehensive survey, by every man of affairs, of the character and tendency of our economic life,

both as it relates to ourselves and as it affects, or may be affected by, the ideas and practices of other nations, now that the intensity of material development and the struggle for commercial supremacy which distinguish our era have brought the whole trading world into the most intimate relations, from which often spring the keenest rivalries or the sharpest antagonisms. Indeed, one of the main purposes moving us to the task we have undertaken in the publication here presented, was to compel a thoughtful comparison of our principles and methods with those adopted and pursued by our competitors, and thus to place under contribution, for our own betterment and progress, the wisdom and experience of every people and of all the past. Our friends, in the many timely and enlightening articles which they have put at our service, have supplied not only the ground-work of such an effort, but also abundant suggestion as to its agreeable and effective prosecution; and we feel sure that appreciation of their good will and generous co-operation cannot be better shown than by making their work the medium of a broad and intelligent view of the best contemporary achievement and of a close acquaintance with the creative thought and the fruitful endeavor of the period.

Whilst there is very much that we may, without assumption, venture to teach to others, there is undoubtedly a great deal more that we may, with advantage, gather from their instruction. It is therefore well that we should look carefully into our own situation, and then determine, simply and without prejudice, to what extent it may be improved by a faithful application of the lessons which can so readily be learned from those who were old in labor and struggle, and also in success, long before we had begun to exist as a distinct community in the family of nations, or even to aspire vaguely to that enterprise which now distinguishes us in a manner as marked as it is creditable.

We are so energetic and so resourceful a people, we have at our command so many opportunities and so many facilities, we are so given to initiative and invention, our vast territory is so blessed with natural riches of every kind and the times are so propitious for their exploitation, our political and commercial relations with the rest of the world are so generally favorable, and our position in many respects is so strategically controlling, that we have become much

too prone to think only of our surpassing prosperity and acknowledged power, due as much to our special advantages as to our admitted ability, and to pay little attention to the condition toward which that prosperity and that power are inevitably and persistently urging us onward. The truth is, that, although the most modern of all great nations, we are, in consequence of the trend of events and from sheer necessity in what concerns many of our interests, steadily assuming the responsibilities and as steadily adopting the policies of the most ancient, and are facing more and more each day, in government and in every phase of industrial and social life, the difficulties and the dangers which have always attended widespread dominion and the accumulation of enormous wealth, and which have constituted, throughout all history, the menace of sustained peace and of the higher progress.

Finance is not an isolated factor. Nothing is more closely associated with the whole range of contemporary development, and nothing is more easily complicated by general conditions. Whether for good or for evil, it affects, and is affected by, the morals, laws, habits, ambitions, tastes, traditions and wants of the people whose transactions it adjusts and whose relations it so largely attempts to shape and to administer. It must, therefore, not be studied from a purely formal and arithmetical point of view, but from that of the complete activities, needs, prospects, character, and connections of the community whose interests it serves. Let us then very hastily scan our history in order to see what we have hitherto accomplished, and look carefully about us so as to learn what we have to do at present and shall be compelled to undertake in the very near future.

To give oneself heartily to such an effort is eminently the duty of the financier, not only on account of the requirements of the highly important task that constitutes his daily work, but because of the influence, direct and indirect, which he can, and in some respects, whether so disposed or not, he must, exert on the whole movement of his time. It is not alone with money and credit, with the clearings of the world's commerce and the support and extension of the world's utilitarian energies, that he is concerned: he has to do, and often to do effectively, with matters far more essential, which touch the most serious interests of individuals and of nations, making for peace or war, for prosperity or misery, for progress or retrogres-

sion. He has a vocation that is among the most important of those assigned to men of action, and by his fidelity to which both humanity and Providence will very strictly judge him, as well in respect to what he accomplishes as in respect to what he fails to undertake.

Within a very brief span of national life we have achieved extraordinary things, most of which have been beneficent and fruitful, and will leave their impress upon the ages to come. They appertain to every realm of human accomplishment: and they bespeak our capacity for government; for material, intellectual, and moral improvement; for the resolution of the doubts and the mastery of the difficulties incident to all salutary progress; and for the conquest not only of new fields of enterprise but also of new spheres of wholesome influence and elevating example. Our advance from primitive conditions has been as rapid as it has, thus far, been certain and safe; and the whole world wonders that we should so easily have triumphed over obstacles which have often arrested the onward march of the most enlightened and powerful of peoples, and even turned backward, at times, the current of civilization. Hence it is meet that we should be exceedingly thankful; but we should, furthermore, remember that the strength we have gained, the superiority we have in many respects achieved, the vantage-ground we have so brilliantly conquered, and the avenues to added success which the genius of the nation is steadily opening and as steadily broadening with each successive decade, have brought, and continue to bring, with them a multiplicity of onerous and trying duties, of which a large share falls necessarily to the man of affairs, and which must be generously discharged lest they become sources of peril and reproach. Should failure overtake us in the performance of our task as a people, it would be impossible to plead aught in extenuation of it; and were we to show ourselves negligent of the obligations we have been only too anxious to assume, it would be more than cowardly to take refuge in excuses based on pretended inexperience, or upon the novelty of a situation created, as ours has been, by a quick succession of unusual events and by a naturally elicited and manifest, though apparently sudden, call to a special mission. We are ever ready to declare that, in the economy of Providence, we have been selected to dominate, in great measure, the destinies of

the present and of many succeeding centuries: let us then be equally ready to acknowledge, in business as in politics and in all other concerns of daily life, the imperative nature of the vocation we admit to have been ordained in our regard, and to work out the plans suggested by it, even to the minutest detail, from whatever sources we may need to draw inspiration, to seek light, or to borrow the requisite vigor and enthusiasm.

We have taken our place in the foremost rank of nations, and we cannot, if we would, retreat from it. Besides, the cares and vicissitudes of the old world have now become equally those of the new; and common problems have to be solved by both, with such wisdom as the former has gained from its two thousand years of civilized life and the latter has reaped amid the ferment of a phenomenal unfolding. It is to be hoped that there will be a generous exchange of good offices, and that the most pronounced rivalry between the two may be witnessed in the attempt of each to surpass the other in effecting those ameliorations which serve to diffuse, as widely as human possibility allows, the benefits to be got from the best thought and the bravest endeavor of both.

The whole world has reached a position where there is supreme need of greater self-abnegation on the part of the strong and the fortunate, and of greater unselfishness on that of the struggling mass; and if there be one thing more useful, more largely beneficent than another, which can be accomplished by those who manage the colossal material interests of the times, it is certainly that of preventing the threatened division of society into two great antagonistic classes, one of which seeks with the keenest ability, the most systematic vigilance, and the nicest manipulation, to secure and to hold all that it can safely get, and the other, with less knowledge and skill but with equal determination, to take all that it may dare to seize under any pretext of right or any tolerance of aggression.

The social problem cannot be divided from the economic; and the banker, the merchant, the manufacturer, and the agent of transportation, must unite to create and maintain that reasonable distribution of opportunity, of advantage, and of profit, which alone can forestall an adjustment that left to itself must needs assume the character of a revolution.

But before we undertake to ascertain how nearly, in any given

case, the laws, customs, and practices of any other country may offer us suggestions likely to prove useful in solving the problems common to all modern communities, or those specifically related to our own development, we should do well to regard somewhat carefully the elements which give complexion to our national life, and thus learn to better determine how nearly the needs of any alien society are analogous to those of our own, and how opposite in our own regard may prove the systems of work, the methods of business, and the treatment of issues, which experience has taught it to follow, and the industrial, commercial, financial, and social safeguards which its observation has led it to adopt.

It is a fact too often overlooked, even by the well informed, that we are a highly composite people, gradually moulding ourselves into a new, distinct, and eminently characteristic type, and that we are very far from being the Anglo-Saxon people we so generally style ourselves from simple want of reflection. Indeed, the number of persons other than those of English descent now going to make up our population, represents undoubtedly an overwhelming majority of the whole. Were it possible to eliminate from our national composition the integral parts directly contributed to it by the Celt, the Scandinavian, the Teuton, the Latin, the Hebrew, the Magyar, the Slav, the Greek, and the Armenian, not to speak of some less important though still appreciable elements, and not to take account of the influence exercised in so many ways by our vast negro population, we should no longer be recognizable even by ourselves. It may almost be said that we have in our veins, in copious measure, the blood of all the strongest and most determined races; and we must seek to profit by the labors and wisdom of each of them, even when the issue is no higher than that of mere trade, and the end in view nothing more exalted than the simple amassing of gain, if we would secure the fullest expansion and the largest efficiency of the force we have, during our short but most eventful period of existence, gathered from the best stock of all mankind and made native, let us believe, for all time. In fact, to do justice to ourselves we should constantly reflect that it is precisely because of our composite character that we occupy so unique a position amidst the family of nations; for, along with the brawn and the brain, we have absorbed a generous share of the moral excellence of substantially every peo-

ple that has, since the beginning of modern history conceived the ideas, supported the trials, executed the plans, and performed the deeds that have made possible the world's present civilization; and, for the same reason, and to understand more fully how large is our responsibility, we should as sedulously bear in mind that no other people than ourselves, among all those now contending for the leadership of humanity, can claim a like genesis or pretend to so extraordinary a heritage.

We have had to settle, to develop, to unify, to make prosperous, to fortify against the eventualities of existence; to bring into harmonious and profitable relation with a number of governments by no means at one with each other in purpose or policy; to train to a loyal, prudent, and earnest discharge of the public and private duties of free citizenship; and to supply with the means of progressive enlightenment and of all the embellishments and reasonable pleasures of life, a country of immense extent and of varying climate, character, fertility, product, and environment: and for each question that has in consequence presented itself, we have, in some one or more of the qualities of our population resulting from special proclivities, sentiments, traditions, or experience, found prompt and vigorous aids to a happy solution. Furthermore, at every period of our national growth and of the unfolding of our institutions, now in many particulars regarded as models of general applicability, we have stood in need of some peculiar force or capacity which, in union with other and equally needed forces and capacities, no one race or people alone could, perhaps, have satisfactorily supplied. We have, it is true, retained the language of England, and many of her customs and laws—some of them most precious heritages; but the debt imposed upon us by our national evolution is one that is owing to all the world.

But this fortunate blending of so many excellencies has, in spite of its advantages, been attended by some difficulties which yet remain to be overcome. It has, notwithstanding our wonderful power of assimilation, in certain cases delayed, and in others rendered arduous and imperfect, the achievement of that social homogeneity and that solidarity of thought and working purpose which distinguish the older peoples. As a result, our attention has been temporarily diverted from certain ideals, and from certain

methods of development and procedure, which, in view of our highest good, demand our study and crave our cultivation.

The events which created us a separate government led us, at the inception of our national career, to be more solicitous for independence than anxious for guidance. We were, in virtue of the circumstances accompanying our origin as a people, given, first by the force of occurrences and then by disposition, to a freedom of policy and conduct which was always praiseworthy but not in every instance sagacious; and the inclination to work out our destiny with as little extraneous aid as possible has, notwithstanding our incessant drafts upon the populations of all Europe, clung to us almost as a principle, even when we might have largely gained by imitation or profited by example.

Virility we possess in an astonishing degree, and we have exhibited it so thoroughly and so persistently that we have placed ourselves in a position where our strength and determination, associated, as they are in the minds of the whole world, with our undoubted resources, and our phenomenal facilities for the creation and maintenance of both power and influence, command the respect and constantly invite the scrutiny and watchfulness of every government and of every interest. But as we have reason to be proud of what we are and what we possess, we also have reason to be solicitous to correct the shortcomings of which we may become, or be made, conscious, and to so far perfect every form and procedure, whether of politics, education, business, or social life, as to make available, to their utmost capacity, the blessings, material and moral, which it has pleased a beneficent Providence to bestow upon us.

During the colonial period, and for a considerable time after the achievement of our independence, we pursued in politics, in business, and in the general concerns of life, the natural and quiet course of our development, much as other nascent communities had done before us; but, starting from the close of the Civil War, the issue of which effected a most important and far reaching change in the opinions and sentiments of our people, in the character of our industrial and commercial activities, and in the policy of our government, we suddenly entered upon a career of rapid, and almost aggressive, material and political advancement, directed by principles of centralization and expansion, which, as might easily have been

anticipated, only served, especially after our triumph in the Spanish-American War and our acquisition of distant and important possessions, to excite more and more our thirst of power, our desire for the prerogatives of empire, and our longing for pre-eminence among the nations. And so we have come to be recognized as a world-power, to be credited with the influence attaching to the status we have assumed, and to be charged with all its responsibilities. Latterly, moreover, our progress in the exploitation of our country's resources has been so wonderful; our population, as well by natural increase as by ever growing immigration, has increased so much; our wealth has multiplied so enormously; our centers of activity have become so densely peopled; our domestic issues have given rise to so many serious juxtapositions; our relations with the whole outer world, civilized and uncivilized, have become so numerous, far reaching, intricate, close, and delicate, that we have practically entered upon the condition of an old world sovereignty, with its industrial, social, and political complications, but with scarcely any of the trammels imposed upon it by traditions and alliances. In a word, the newest of the great powers has, in many ways, and with a peculiar significance, taken on the aspects, appropriated to itself the functions, and, in large measure, adopted the policies, of the oldest, and is now, as the result of both its growth and its ambition, called upon to meet the problems it has either created or solicited, though not yet fully realizing the import of some of them, nor being willing to admit that all of them will presently have to be solved.

And here it is appropriate to remind all those who may peruse this volume that in future our leaders of both thought and action, financiers among the rest, and in many respects especially they, must greatly broaden the range of their vision, and more diligently study both general and local conditions, not as things capable of being wisely considered apart, but as things not less essentially united in practice than they are allied in principle. Finance should, indeed, be regarded not merely as a business, but also as a profession. In many of its phases it is as much entitled to respect as is statesmanship, and in some of them it plays quite as serious and important a part. In the world of affairs it constitutes the highest possible sphere of finished operation, and in the movements of common life it is the motive force upon which depends the whole machin-

ery of productive and distributive activities. It is entitled to be philosophically considered at the same time that it is practically applied, and it should be regarded by every class of workers and observers as offering a career worthy of the best talent and entitled to the most distinguished honors; indeed, it cannot be otherwise regarded in any community without a suggestion that there is much ignorance to be combated and much prejudice to be overcome. The progress we have made in the practical uses of it as one of the factors of ordinary material advancement, has indeed been considerable; but that which we have achieved in the scientific development of it as a potent means to the uttermost possible diffusion of the blessings of a highly organized civilization, has certainly not responded to the desire and the hope of those most loyally and intelligently interested in our welfare. As a matter of fact, we are, in respect to many things which concern both its theoretical scope and its utilitarian functions, far behind at least several of the nations of the older world whose ideas we are prone to regard as antiquated, and whose ways we criticize as arbitrary, cumbrous, petty, and narrow. To go fully into details with a view to prove the truth of this contention and to turn that truth to the best account, would speedily betray us into writing a volume more ample in size than that to which our present remarks are designed as an introduction; but it is easy to signalize a few things of special importance and of large present interest that are striking enough to suggest at least the fairness of our statement and to excite a disposition in favor of earnest and unprejudiced investigation. This done, we may safely, and with confidence in the results we are anxious to secure, commit to the study of open minds the various discourses and papers here gathered together, in so many of which can be found useful hints as to our shortcomings, encouragement as to our well conceived purposes, and enlightenment as to the principles and methods to be comprehended and employed in our procedure in order that we may master the possibilities of our situation and may assure to ourselves the advantages with which our future is pregnant in so generous a degree.

In the first place, our system of currency and credit, which is necessarily at the bottom of all business movements, and which should be automatically responsive to every condition of trade, and

equal to every industrial and commercial emergency, however created, is admittedly inelastic, satisfactory as some of its features undoubtedly are, and, as experience unceasingly proves, is sometimes lethargical, sometimes provocative of strain, and sometimes an invitation to rash speculation or unscrupulous manipulation. It lacks delicate adjustment, the percolating quality essential to a constantly maintained equilibrium, and especially the faculty of rendering as efficient service to small as to large transactions, to isolated as to closely connected fields of operation, to minutely subdivided as to highly concentrated capital. This condition is not due to any want, on our part, of either ability or resourcefulness; but to the absence of scientific co-ordination, so natural and so usual in countries relatively new, and to a certain vanity and a somewhat reckless spirit of independence inducing us to eschew imitation and to crave initiative. Models in accordance with which we might work for our betterment are so far from lacking that they may almost be said to abound; and they are so completely beyond the charge of empiricism that their rational and sustained success has become well nigh proverbial. We have only to look across our border to the north to find much to which we might conform with unqualified advantage. Our Canadian neighbors, with less resources and less experience than ourselves, but, we may fairly claim, with no more aptitude for intelligent enterprise, though certainly with greater reverence for authority and more native respect for wise precedent, have largely escaped, by adherence to well devised methods, many of the difficulties with which we have to contend and many of the risks we have to encounter. They are free from the menace that lies in the interference of the government with banking; they have not to encounter the danger to metallic reserves inherent in the large amount of our outstanding treasury notes; they are able, by their system of branch banks, their treatment of the circulating notes of their financial institutions, their habit of unlimited rediscount and other safe and tried means, to make their currency and their commercial credits well nigh as fluid as the waters of the ocean, and well nigh as obedient as they to the varying conditions which demand, now here now there, a change in channel or in volume. But if we please to look farther, and take lessons from the practice of the transatlantic world, which if it be less exuberant than

ourselves, is as far as we from being effete, we shall find awaiting our study and soliciting our imitation an array of ideas and a display of plans and methods which we cannot too respectfully consider or too diligently compare with our own notions and usages.

We dare not, without trenching on ground assigned to others, and to which it is our function simply to direct attention, undertake to discuss the subject of vast importance we here present in passing; but we crave for it special thought, since it constitutes for us a practical issue, and is at this very moment clamoring for a wise solution.

As to the diffusion of trading facilities and advantages designed to place the smallest dealer, in respect to his limited wants and within the scope of his restricted operations, on a parity with the strongest and richest merchant; as to the opportunities offered to the mass of the people for the direct and safe investment of very small sums in the best of securities, and their instant and easy withdrawal, freed from the burdens of intermediary profits and the risk of speculative mismanagement; as to the means placed at the command of borrowers on mortgage to secure cheaply and to pay at leisure by amortization, and therefore at the minimum of charge, the moneys they may require, whether in trifling or in great amount; as to the government of corporations and of those huge aggregations of capital and vast combinations of effort which we call "trusts"; as to the whole field of international banking and the much needed unification of standards and methods in international trade; as to the happy solution of the great industrial and social question which is pressing heavily upon the very life of all modern peoples; and as to other things of grave moment and present concern, we have enough to learn from our European compeers to make us persistent and grateful students for a generation to come.

We may, let us repeat, with eminent justice boast of the more than substantial progress we have achieved; but we cannot, strong though we are in the vigor and earnestness of our splendid youth, afford to ignore, much less to despise, the wisdom of the ages. Were it not that we are inundated by the riches of a virgin and most fruitful land, which is perpetually yearning for an increase of its inhabitants and perpetually offering to all mankind the allurements of an exhaustless bounty; and were it not that the admirable nature

of our institutions and the abounding chances of advancement resulting from the industrious exploitation of our measureless resources unite to inspire ambition, to encourage hope, and to promise speedy and ample reward, we should to-day be in the throes of many a problem fraught with not only grave anxieties but also with serious peril. As a matter of fact, we are, in respect to several very disquieting questions, already on the verge of such a state; and we should fortify ourselves for the oncoming struggle by promptly taking all the precautions which our own experience or that of others may suggest as serviceable and sustaining. We wish, and assuredly with all heartiness, to avoid the errors and misdeeds of the older world, and happily we are in a position to do so without extraordinary effort; but at the same time we certainly desire to profit by its trials, to gather fruit from its labors, to make ourselves heirs to its wonderful experience, and to share its numberless victories in both the material and the moral order.

Already hundreds of thousands of our people, notwithstanding the plenitude of our national blessings, are engaged in a fierce struggle for existence, contending at one time with the tyranny of selfish organization, and at another with the cruelly alternating conditions of abundance and scarcity of work, or of prosperity and stringency in business. And here it becomes the duty of our captains of finance to devise plans for the more thorough equalization of life's earnings, the broader and more constant diffusion of opportunity, and the more thorough utilization of individual ability. But, in doing this, it is just as important to profit by the force that exists within us as to take advantage of that which is extraneous; and we would plead, with all the earnestness of which we are capable, for a closer and more disinterested union among those who, in the order of Providence, have been charged with the task of shaping the material destinies of our people, and, in doing that, of promoting, though by indirect means, their intellectual enjoyment and their moral happiness.

Fortunately the association of our bankers in the national society and the local reunions which for some years have drawn them more and more closely together, and that excellent affiliation of the working force of our moneyed establishments known as the American Institute of Bank Clerks, have, in both the higher and the lower ranks

of the financial world, done an exceeding amount of good by the dissemination of sound ideas, the suggestion of useful reforms, the encouragement of systematic effort, and the spread of profitable knowledge; but it is in the carefully concerted and loyally supported plans of the master minds of our business hierarchy that we must seek to find the best assurance of that solidarity of purpose and that uniformity of wise and good example to which we must look for the perfecting of our commercial life and the realization of our destiny as one of the greatest and most beneficently productive communities of the present and of all other times.

Let us hope that the volume we here offer to the consideration of the earnest and patriotic workers of the day may, in some small measure, stimulate minds to a wholesome activity and encourage aspiration to take the trend of the higher commercial life, so closely allied, in an era like this, with the higher life of every kind.

CHARLES FRANCIS PHILLIPS.

New York, 3rd September, 1906

PART I.

GENERAL BANKING SECTION

BUSINESS EDUCATION AND COMMERCIAL AND BANKING METHODS

ADDRESS DELIVERED BY HENRY CLEWS, OF NEW YORK CITY, BEFORE THE MINNESOTA BANKERS' ASSOCIATION, AT LAKE MINNETONKA IN JUNE, 1905.

I NEED hardly say that the bankers of this country are deeply interested in the choice of methods for directing and developing our productive energies, and in the development of the mechanism by which our business is controlled. On the other hand, the brokers of the community who deal in stocks, bonds, commodities, and other property are earnestly interested in having monetary values kept sound. They are primarily desirous to see investors protected from the irregularities and fluctuations produced by the misuse of credit or misrepresentation.

It is often supposed by thoughtless persons that some natural opposition exists between bankers and the investing public. Some go farther and assume the existence of such an opposition between the consuming class and the bankers of the country. No errors have been more mischievous in our economic and political life than these. What hurts the financial interests of the country injures its great public. The greatest error of all is the belief in an opposition of interest between "Wall Street" and the bankers of the nation. Their interests are identical, and commercial soundness is equally the foundation of both.

The problem from this common standpoint is the method to be employed in the proper extension of credit and the development of appropriate machinery for its use. Commercial conditions in the United States are anomalous in many ways. We have produced a marvelous industrial and technical equipment for the production of raw material and the manufacture of goods. We have developed a system of transportation which has no equal, and elaborate and efficient machinery for exchanging commodities and values has been built up. Practically the whole of our industrial and economic mechanism has been reconstructed within the past few years.

In this great process of development and growth, it is not strange that some departments of business have lagged behind others and of these unsatisfactory elements the most conspicuous is that of organization and management. Our business men have considered that a properly minute and careful attention to the details of administration and operation was sufficient. They have too often neglected to follow and profit by the obvious changes in organization, which, if adopted, would save them much personal effort and—more important still—keep them from actual ignorance of the condition in some respects of their own enterprises. But, of many improvements that might well be introduced into our commercial practice, the one of primary significance is the adoption of intelligent methods of accounting and auditing by all corporations or associations of persons which employ a considerable capital. The time has certainly arrived when the old and familiar systems of "bookkeeping" will no longer fittingly and advantageously answer for the conduct of modern financial business. It is now impossible for the manager of any large business to oversee in person its various operations and details. Results must be reduced to a scientific basis; they must be classified with the same minute care that a scientist would devote to the arrangement of a series of plants belonging to a new family or genus. This need for reform and for scientific method is not confined to any one group of institutions or any particular species of business enterprise. It is a general, if not universal, need, resulting from the great growth of our activities, both in their scope and in the amount of capital they involve. Nor is it confined to private enterprise. It extends also to municipal governments which, influenced in part by the work on accounting which is being done by the Census Office, are casting about for ways by which they may reorganize their business and statistical methods.

It will not, however, be sufficient for our business men merely to revise their methods along the lines indicated. There must be added a system of publicity of accounts which shall convey to the investor, in a sincere and unmistakable way, every business detail that he has any right to know.

I do not mean by this that the legitimate secrets of incorporated companies should be thrown open to the searching eyes of business

enemies, or competitors. In introducing a proper system of accounting and auditing, there should be full recognition of the distinction between what Mr. James B. Dill calls "private publicity" and "public publicity"—publicity for the investor, the man directly concerned in the business which employs his funds, and publicity for the prospective investor, the legislator, and the press. Our legislators would do well to overcome the defect in corporation laws from which, in many states, injury still results—that of failing to recognize the distinction between companies which are public in their nature and methods, and those which are private. Nothing can be clearer than that a company which looks to the general investing community for resources should give to that public statements so clear and precise that its financial standing and the character of its management can be properly estimated. On the other hand, the time must soon come when stockholders owning considerable portions of the capital of incorporated companies, whether public or private, will have the right to demand minute investigations and reports upon their operations and assets. Such reports can be intelligently made only where proper methods of accounting are employed, and where the inspection is made by a man of special training for the work. So far as relates to public companies and their accounts, it would be better that the information should be voluntarily furnished to the public than that it should be exacted under forms of law, and perhaps under conditions that might be, not merely distasteful, but positively injurious, to the concerns affected.

There has of late been a remarkable growth in the intensity of prejudice and opposition displayed toward large corporate undertakings, or trusts. Much of this has been intelligent, while some has been malevolent and imbued with class prejudice, and often ignorance has been the foundation of opinion. The growth of a habit of furnishing such accounts will have a twofold effect. It will furnish a fund of information that will go far to dispel this ignorance and prejudice; and it will meet a growing public demand halfway. By conceding fully and frankly all that the public has any right to ask, the unfair criticism, which is now encouraging hostile forces, will be divested of its menace to private enterprise.

It is often urged against such a policy that it would foster com-

petition and invite hostile legislation or unreasonable taxation. But these are precisely the results that it would be likely to avert. The drift of the times is wholly toward large combinations, and nothing is so strong a deterrent to companies or persons proposing to enter a given field as the knowledge of the difficulties which any particular business has encountered, and the greatness of the volume of transactions required to produce satisfactory profits, as well as to insure the economy necessary in order to show any gains whatever. Such fair and open statements, too, will form the most reliable safeguard against municipal ownership. All this, of course, presupposes, on the part of corporations, honest returns and a wide and public-spirited policy upon which they can afford to go before the world.

The successful carrying-out of these ideas will imply the co-operation of skilful public accountants and auditors, equipped with that thorough knowledge of economic principles which will enable them to formulate systems of classification, and show not merely the financial condition of a given business, at a stated time, but the commercial facts upon which its affairs rest and on which its future prospects of success must depend. Such a body of experts is already in existence, though the number of competent men is perhaps small, and far from being well distributed throughout the country. The men available are, however, increasing in number, and their profession is gaining in respect and consideration. We have a number of chartered accountants of Scotland and England who have served the minimum apprenticeship of five years, and have passed the rigid examinations in general accounting, commercial and bankruptcy law, and actuarial science which are required before their diplomas of C.A. are accorded to them. In at least four states we have now distinct legal recognition of the accountant as a professional man, the standard being set by the state of New York in its Public Accountants Act, which grants the title C.P.A. to all such as pass a specified examination. This example should be followed by other states. It would be well if these laws required the serving of a five years' apprenticeship before applicants could graduate.

In banking we find no exception to the general backwardness of method of which I have been speaking; and as our bankers are the leaders in commercial thought, other members of the business

community can hardly be expected to be more progressive. Says ex-Secretary Gage: "It is a strange anomaly that, while in nearly every other department of life improvement is the indispensable rule, in the field of banking, finance and, exchange we go on with an indifferent regard to the handicap imposed by defective methods." These words, though uttered some time ago, have been given unexpected and special significance by recent unfortunate happenings, on which I need not dwell, but which indicate the need of radical changes in bank examinations, as well as in the relations of our banks with their customers and correspondents.

It should be remembered that defective methods are more dangerous to the community in banking than in any other form of business. Individuals and corporations, needing to borrow money, present to the banks, when required, evidence of assets, and ask them to recognize the worth of these by granting credit thereon. If the banks accommodate their customers, they practically guarantee the value of their assets, or the collaterals offered; and, in case they err, their capital must pay the forfeit to the extent of their mistake of judgment. But unreasonable pessimism at a critical moment may lead to an undue contraction of credit, involving failures and panic, just as too confident optimism may produce unfounded inflation and excessive speculation.

While there is this hazard of error in either direction, and the greatest good to the community can be realized only by correct judgment, the danger of accepting weak security is greater than that of rejecting sound foundations for extensions of credit. The Indianapolis Monetary Commission, writing in 1897, from an analysis of the Comptroller's figures found that of 328 bank failures reported during a period of years, 139 were connected with injudicious banking, or depreciation of securities generally due to bad management.

Though it is true that a lack of wise judgment in business can never be guarded against, it is evident that the percentage of error may be greatly reduced by proper methods of gaining information concerning the facts upon which judgment must be based. A defective system for obtaining such information must be held to be primarily responsible for the errors of judgment committed by bankers, who are as competent a body of business men as can be

found in the world. The question of sound credit is thus exhibited as the problem of finding ways and means to reduce the granting of credit to a science.

It is evident that in the performance of this most important function the banker is entitled to all the aid that he can secure. And it must be added that there has been steady progress in the means adopted for assuring the character of this basis for credit. It was perhaps the most perfect system of granting credit when the local banker, like David Harum, knew every borrower in his own community and could make proper allowances for personal untrustworthiness, or give personal integrity and initiative their due weight as security for the payment of loans.

Unfortunately, the direct personal touch is lost as commercial communities grow larger and commercial life becomes more complex. The old methods grow antiquated, like the stage-coach and the wooden sailing-vessel in the face of modern ideas of transportation. In order to take their place, an ingenious mechanism has been developed in our best institutions. The older and more familiar method of lending upon general knowledge of the strength of the names presented, and upon information as to the main circumstances of the business, gathered in some more or less casual way, has been discarded. In its place there is now being generally substituted throughout the country the practice of requiring borrowers to make full statements of their business before granting them any accommodation, and a complex and highly developed system of recording and classifying information concerning borrowers has been evolved.

The man who would get credit must fill out forms which furnish, in more or less detail according to the circumstances, the data which will enable the bank to judge of his business. In the modern financial institution the "credit department" has become the regulator of the whole mechanism. Some consider the present requirements of full statements and appraisement unreasonable. There has probably never been a change or forward step in business practice that was not so considered by some of the persons affected by it. Yet no change in our banking methods can be more conspicuously justified than this. It has long been in vogue in foreign countries where

banking is more nearly a profession than a business. Says Professor Albert S. Bolles:

> A borrower wishes a bank to put its funds for a time completely beyond its reach; surely he ought not to expect that this will be done, unless assured that the money will be forthcoming at the time promised. Ought the bank to be satisfied with his promise that he will do so? We all know what a wide and impassable gulf there often is between intention and performance. The applicant may be perfectly honest and have the best intentions, but a true disclosure of his affairs might at once lead the bank to decline his application.

The fact that many of our business men, even those who are leaders of thought in their own communities, continue to employ antiquated methods in the conduct of their business and still depend upon out-of-date forms of statement, entails grave danger to the credit basis of the community. And this danger is the greater because those who are the cause of it have no intention to deceive. Some, when they become involved, purposely resort to misleading methods of statement, or even wilfully misrepresent the state of their affairs. But these are the exceptions. The truth is that this is more than a question of personal honesty and honor. It involves the commercial soundness of the community, and every effort should be employed to ascertain facts, and make sure that the statements submitted by applicants for credit correctly represent the state of the business to which they relate. Our practice has, in this regard, been far too lax; and a long step toward sounder conditions would be taken, were our bank managers to require the certification of the balance-sheets of borrowers by competent public accountants. Such a plan is followed in European countries with most satisfactory results.

The banking community can do much toward the introduction of sounder methods of accounting and better business practice. The requirements that the banker makes, the principles that he lays down, will be accepted by those who look to him for light and leading But there is another factor in the movement that must be considered of controlling importance. This is the proper education of those who are to become our business men. I do not in the least deprecate the services and splendid initiative of those who, by their own unaided abilities, have brought this country to its present commanding stage of development. They have laid the foundations of

our commercial prosperity deep and strong. I do them no injustice when I say that, in the new career of world-commerce upon which we as a nation have entered, there is pressing need for a new kind of technical instruction in commercial subjects which shall at least equal, and if possible surpass, that which is afforded to young men in Europe who are contemplating a commercial career. The recent marvelous advance made by Germany in gaining control of the markets of the world is largely due to the minute and careful technical instruction afforded to her people by a thorough system of technical, trade, and commercial schools. And what Germans have done by their technical and industrial training they are beginning to do through their commercial education. Inquiries made by the London Chamber of Commerce not long ago showed that at least 35 per cent. of the firms interrogated there employed foreigners, principally Germans. Many gave it as their opinion that foreign training was such as to fit its recipients so fully for modern commerce as to preclude the possibility of successful competition by others.

The question of introducing such a system of instruction in this country has been much discussed. It has been asked whether it can properly be furnished by our higher institutions, and some have doubts whether it can be given at all. That existing methods in education are unsatisfactory, and that a new kind of training should be substituted for them, is beyond question.

Granting that the new education for business men can and must be given in place of, or at least in addition to, existing curricula, the question still remains: By what group of institutions should such training be furnished? Perhaps this question can best be answered by briefly stating what is actually being done. The past few years have witnessed a remarkable increase in the number and scope of courses in economics, finance, and kindred subjects that are being afforded by our colleges, and there are now few colleges of importance in which such instruction is not afforded, and fewer still where it is not recognized as indispensable. Too often the instruction afforded by our higher institutions has been abstract, hair-splitting, devoid of relation to actual life. It has been metaphysical rather than practical. But this trouble is now at last being apprehended, and the remedy is beginning to be applied. In six or eight American universities earnest efforts are making to offer courses

that shall be truly representative of practical business. At the School of Commerce, Accounts, and Finance of the New York University, at Dartmouth College, at the Wharton School of Finance in the University of Pennsylvania, and at the Universities of Chicago, of California, of Wisconsin, and elsewhere, this effort is being prosecuted with zeal and with hopeful chances for success.

Practical courses in banking, accounting, transportation, corporation finance, international exchange, industrial processes, and kindred lines of study, are being developed, and a new literature, practical rather than theoretical, is appearing. The process will be a long one, but a sound foundation is being laid. How real a start the new movement is getting can be realized from the fact that, during the past eighteen months, at least five American university presidents have attempted to bring together men who had pursued a business specialty, and who were capable of giving instruction in it.

The accountants' profession, in view of its great and growing importance, ought indeed to be definitely and formally raised to a higher level. Every university, and every college, should have an accountants' school, just as it has a medical school or a law department, and give diplomas to accountants on graduating, as it would to graduating students in either of the other departments. A separate degree for accountants would, of course, have to be credited; and this degree would not only definitely and formally elevate their business to the rank of a profession, but command public confidence in their work, so that their certificates of the results of examinations of accounts would be accepted as reliable and conclusive by the public.

While something has been done, and much is now doing, far more still remains to be done; for ultra-conservative men still cling to the older type of education. The task of popularizing the work, of carrying the new ideas of training over the length and breadth of the land, will be a labor of many years. Its complete and ultimate success must depend upon the bankers and business men of the country. What they demand and what they support, that we shall have in time, and not until our technical and commercial education is raised to a par with that of other countries shall we reach a sound and safe and equal basis of competition with them in that respect.

In proportion as well-trained men take their places everywhere in the industrial life of the nation, will new and exact methods be everywhere introduced and improved upon, and the foundations of our commerce and credit be strengthened.

But, without reference to the broader effects of the new commercial education, more careful scientific accounting and auditing will not only reduce bank failures to a minimum, but lessen the danger of loss to banking institutions from erroneous valuations of the security offered for loans and unwise discounts. If these points be conceded, there are several important inferences that may safely be drawn from them. Probably the most important of these inferences relates to the basis upon which our bank-note currency now rests. Given a continuance of present conditions, the rapid reduction of United States bonds is a foregone conclusion. Already their price renders note issues based upon their deposit with the Treasury of little or no profit to the bank which puts them into circulation. The objection to existing conditions is greatest in the limitations placed upon the reduction of circulation which seem designed for the very purpose of preventing the attainment of elasticity in our bank currency. The national banks are in imperative need of a removal of the unreasonable limitation upon withdrawals of bonds, and of the introduction of such other minor changes as will tend to render the national banking system more responsive to business needs.

The proposal to do away with the United States bond security behind our national bank note issues, and to place them upon the same basis as the Canadian bank-bills, has often been mooted. Two classes of reasons are commonly assigned for our failure to accept the experience of other nations in regard to the conditions of issue of bank-notes. One class relates to the difficulty of properly supervising the banks themselves, and assuring their honest administration of the funds committed to their charge; the other, to the difficulty experienced by bank officers in properly judging the worth of the assets upon which the new note currency would rest. All these considerations are evidently reducible to the single one of security. In other words, let proper security be assured and there is nothing to be urged against the abandonment, at least in part, of the United

States bond deposits as a basis for circulation and the introduction of a more elastic currency system.

The banker who doubts the possibility of issuing a safe currency based on commercial assets never questions the worth of his own assets and of those possessed by institutions conducted upon similar lines. He complains of the danger of bad loans, of fraud, of unsound banking, on the part of other institutions. It is obvious that all banking within its own sphere, whether local, national, or international, should be as good as the best. If examinations are inadequate, we should see that they are made more rigorous; if doubt exists as to the value of a borrower's assets, or of the security offered, we should clear it up by demanding statements as to the condition of the borrower, or the value of his collaterals, made upon scientific lines and guaranteed by expert inspection and certification, or refuse accommodation. This is the plan now rapidly coming into vogue among large New York institutions, and there is no reason why it should not be adopted throughout the country.

I do not know of any better evidence as to what can be done by the application of expert methods in insuring the soundness of assets than that offered by Hon. James H. Eckels in a recent address before the University of Chicago School of Commerce. He said:

> Since I have been at the Commercial National Bank we have bought, in four years, some $70,000,000 of commercial paper, and of that we had only one note not paid at maturity, although it was paid later; and one of $10,000 on which there was a loss of $2,000.

The benefits to be derived from an elastic currency have been so often and so well set forth that they need no recapitulation from me. Why, therefore, should we quietly put up with existing evils? Other countries are enjoying the fruits of proper currency methods in the shape of low interest rates, sound credit systems, and assured knowledge of business conditions. Yet we still lock up in unavailable bonds large portions of our banking assets, which, so far as active business is concerned, might as well be underground. With improved business practice, with proper precaution for judging collateral security, and credits, and above all with a community of young business men trained in the best methods of the new education, we may look forward to a conservative forward movement toward sounder credit, more solid banking, and more responsive currency.

Meanwhile, with regard to our national banking system, I suggest one very important preliminary change that Congress should authorize without delay, and that is, to allow the national banks to deposit, with the United States Treasury, state and municipal bonds approved by the Comptroller of the Currency, as well as bank assets, to secure one-half the currency they may issue. This would induce them to take out more notes than they find it profitable to do under the present law, which requires all their circulation to be secured by United States bonds.

These, however, are so high in price that they yield an extremely low rate of interest, and there is little inducement to buy them even by the small country banks, which bank largely on their circulation, whereas the large city banks bank on their deposits. Secretary Shaw has already taken a step in this direction by accepting state and municipal securities to secure government deposits when we have had a stringent money market, and Congress will, I think, be willing to so amend the National Currency Act as to permit of the suggested change. The effect of this half-way measure would be great and immediate; and we urgently need this widening of the foundation for national bank-note issues, in view both of the high price and of the extreme scarcity in the open market of United States bonds, and the constantly growing requirements of our rapidly growing population for currency.

In particular, bank assets should be made available in the same way as United States or other bonds for circulation, the one form of security being practically equal to the other when both are good; and of course they would not receive the approval of the Comptroller of the Currency unless they were. Bank officers all over the country should use their influence with Congress to bring about this desirable result.

In our rapidly progressive age, whatever is obsolete or unnecessary, or a hindrance to development, should be swept away like cobwebs, and whatever is most direct, time-saving, and conducive to our national prosperity and legitimate expansion, within the limits of safety and sound banking, should be adopted. Old-fogyism should not be allowed to stand in the way of needed reforms or obstruct the march of progress, either in banking or in general business, and the financial and commercial policy of the nation should

aim to leave banking, domestic trade, and manufactures, and foreign commerce, as much as possible, untrammeled by needless restraints.

Among minor matters, the present cumbersome and expensive customs of settling foreign exchange balances by shipping gold from this country to others, and vice versa, should be superseded by an international gold clearing-house. The details of this could be easily arranged by means of a gold note currency issued against gold deposits, and a mutual agreement between the large banks here and those in Europe. It has such obvious advantages that the sooner this international clearing-house method is adopted the better. It will save not only the freight and packing and insurance charges, and loss of interest on gold in transit, but the heavy loss by abrasion consequent on transportation. It will save time, risk, and uncertainty, too, by making cable telegrams take the place of gold shipments in the transmission of credits. By taking the initiative in this and the other matters suggested, we shall be foremost in the march of improvement.

HOW FOREIGN COMMERCE BENEFITS THE AMERICAN BANKER

ADDRESS DELIVERED BY W. L. MOYER, PRESIDENT OF THE MECHANICS AND TRADERS BANK, OF NEW YORK, BEFORE THE MISSOURI BANKERS' ASSOCIATION AT ST. LOUIS, MAY, 1903.

It is safe for me to assume that there is scarcely one of us who has not frequently during his banking career been confronted by the problem of how to maintain dividends when interest rates fall, or when competition becomes so keen as to prevent the profitable use of his funds. It seems, therefore, fair to presume that any policy, pursuance of which may with safety exercise a favorable influence upon the profit account of a bank, is a welcome topic for consideration and discussion. Recent circumstances have caused me to devote time and thought to a question to which I had previously given comparatively little attention, viz., the extension of our banking system to other countries.

Before taking up this subject "How Foreign Commerce Benefits

the American Banker," specifically, it is proper to ask a question: "Upon what does a bank depend principally for its prosperity? What condition, outside of the bank itself, works for its benefit?" Without hesitation one may reply that that which is of prime importance is energetic, healthy commercial activity in the community to which the bank looks for its business. The truth of this statement will not, I think, be questioned; granting its truth, we reach the conclusion that, other things being equal, any force or circumstance that tends to develop and expand the commercial activity of a community is of vast benefit to its banks. In view of these facts and with our experience as bankers, let us try to see what can be done to attain the best results for our banks and show a sustained profit for our stockholders.

In its early days a community is the center of a sparsely settled area, where the people are engaged in agriculture, stock raising, lumbering or mining. The community has very little money, and the first business of the bank is limited to loaning its own funds at rates which, although high, are those which the borrowers must pay, having no other recourse. As the development of the neighboring territory progresses, and the wealth of the community increases, the bank becomes the custodian of its surplus funds, and by loaning them at fair rates realizes good profits and earns large dividends on its capital.

With the increasing wealth of the community, however, banks increase in number, individual lenders compete with the banks, and interest rates fall. Furthermore, the production of the community soon reaches its own consuming power, and unless there be an outlet for its surplus products, business stagnation follows, the period being one when the needs of the community are about met by its own production, with a comparatively small demand for money. This condition is disadvantageous for the bank.

But new enterprises come in, new railroads enter the territory and provide outlets for its surplus products, and increased business activity follows. While the increase in wealth in the community through the sale of its surplus in other markets offsets the demand for money with which to cultivate larger areas, and so prevents any decided rise in the interest rate, the growth in number and volume of the bank's transactions, resulting from the new commercial activity

and life of the community, brings to the bank another period of profit.

This stage in the history of a community and its bank continues until the development of the natural resources in the surrounding territory has reached a maximum. Then comes a second period of stagnation, often one in which, because of the quantity of idle money in the district, interest rates seek a lower level or a large surplus is carried at small profit, and the bank's earnings fall in proportion, making it difficult to maintain the dividend rate.

Then comes the manufacturing period, and with it the employment of the funds of the community in new enterprises. Here we pass through the same phases as before; both community and bank repeat the experience of the period of natural products, the engagement of the funds thus employed at first bringing in better interest rates for the bank. When the manufactures equal the demands of the community, there comes another time of business depression. Then the increase in the capacity of the factories and the shipments and sale of their wares to other parts of the country cause renewed activity in the business world, a corresponding time of prosperity for the bank, progressive growth, both in the wealth and the life of the community, until the time when the output reaches the capacity for consumption of the country itself. When that limit is reached there comes again in the life of the community, and of all communities similarly situated in the same country, a time when business seems to be at a standstill and banks suffer accordingly.

Standing at this point, and seeking a remedy for the stagnation of business, we must be governed by past experience. In each case you will see that the period of depression has been relieved by reaching out for broader markets. Thus, and thus only, may the surplus products of the community be disposed of and its commercial life be made broader and stronger. Thus it appears that when a nation reaches the point where its natural and artificial products outstrip the nation's needs, the further growth of its commerce, upon which the prosperity of the bank largely depends, calls upon the nation to enter the field of foreign commerce. If the foreign commerce of the country be then encouraged by every legitimate means at hand, the nation's commercial elements will respond and with that response will come an increase in volume of the banks' transactions and corresponding profits.

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Leaving for later consideration the various ways in which the banking community will profit by the development of foreign commerce, and accepting the conclusions reached, let us review the various phases through which communities and their banks have passed, and get the benefit of their experiences.

The commercial life of the community and the prosperity of the bank go hand in hand, and if the banker would benefit himself, he must do so by using the trust that the public has reposed in him for the upbuilding of the legitimate commercial life of that community. Thus we see that in order properly to answer the question: "How can foreign commerce benefit the American banker?" we must also answer the question: "What can the American banker do to build up and extend our foreign commerce?"

The extension of our foreign as of our domestic business depends upon the confidence of the commercial community in the banking facilities available; i.e., in the ability to furnish accurate information about the standing of prospective customers, in the prompt collection of proceeds of sales made in distant localities, and in making advances as needed. No foreign bank can handle our foreign business satisfactorily in a distant land. Our banks, through foreign branches or agencies, must be able to follow our foreign trade through all its wanderings from factory to market. If a bank do less than this, it will satisfy neither its customers nor its stockholders. Hence, in order that the nation's commercial community and the banking world may continue to reap the legitimate fruits of their growth, the banking system of the country must be extended beyond the country's boundaries.

These facts have long been recognized by other nations, particularly by England and Germany, and it is through this recognition that they have been able to develop their foreign commerce, the profits from which have added enormous sums to the wealth of the home countries. With no experience of our own to guide us, it is but prudent to understand and appropriate that of the pioneers in the field, and it is perhaps fortunate for us that the particular sphere in which these nations have displayed great activity is that to which the logic of events naturally causes us to turn our attention.

The Treasury Bureau of Statistics, in analyzing the international commerce of the principal countries of the world, estimates that the

total annual value of the manufactures which enter into this commerce amounts to four billions of dollars, of which sum the United States furnishes 10 per cent. or $400,000,000. Of this enormous total the United Kingdom supplies one billion dollars, or 25 per cent.; Germany supplies 20 per cent.; France about 12 per cent.; and the Netherlands about 6 per cent. You will note these four nations supply almost two-thirds of the entire amount of the commerce of the world.

Strange to say, the nations which are the largest exporters of manufactures are also the largest importers of manufactures; this being due, in part, to the fact that much of the material which they use in manufacturing is produced in other countries and imported in the first stage of manufacture; while other manufactures imported are composed of articles produced in other parts of the world and not produced in the countries in question.

In the case of Great Britain, for example, which imports seven hundred and twenty-five millions of dollars of manufactures annually, nearly thirty-six millions represents the value of copper, chiefly imported from the United States in the form of pigs and bars in the first process of manufacture; sixty-five million dollars manufactures of silk, of which the material is not produced in Great Britain; sixty-three millions of dollars of wool, a large part of which is imported in the first stage of manufacture; sixty-seven millions of dollars of food and drinks, chiefly in the first stage of manufacture; and more than fifty millions of dollars of leather, which after importation becomes a material for use in manufacturing.

Exportation of manufactures exceeds importation in Great Britain, Germany, France, the United States, Austria-Hungary, Belgium, and Switzerland, while in all other countries in the world importations of manufactures exceed exportation. Turning to the import side we learn that manufactures form 76 per cent. of the importation into Australia; 68 per cent. into the Argentines; 57 per cent. into Canada; 53 per cent. into Japan; 38 per cent. into the United States; and 28 per cent. into Great Britain and Germany.

The important field now open to us, from which we derive comparatively little benefit, is the Orient, the trade of which, from our relative geographical position, no less than from our superior facilities for handling it, properly belongs to the people of the United

States. Facing the Pacific and South Pacific Oceans is a population of seven hundred and fifty million people, whose commerce to-day represents the enormous sum of more than two billion dollars per annum. Of this the United States handles less than 10 per cent. or two hundred millions, while the profits resulting from the remaining 90 per cent. go to European banking houses and merchants instead of to our own.

England and Germany have pre-empted the Oriental field and gained a firm hold on its commerce which they will be slow to relinquish. Encouraged by the presence there of powerful representatives of their respective nations, by the influential position held by their banking establishments, and by the ready help they extend, natives of England and Germany have sought these distant shores, have lived and prospered there, and have greatly extended the business of their adopted countries with their native lands.

To cultivate that foreign commerce, and to give us an equal chance with England, Germany, and other countries, it is as necessary that we should follow their example and have our own banking institutions in those markets to promote and facilitate the trade which our goods create, as it is that any army in a distant land should have a supply department. The latter furnishes transportation, provisions, forage, etc., to the troops, and follows the army in all its movements. In like manner the bank supplies its customers engaged in exporting with the facilities necessary for the movement of their products to foreign shores. An international bank drives home the wedge of a country's commerce in a foreign land. Only when a bank works for it will foreign trade expand. It is a familiar saying that "commerce follows the flag," but unless that flag is a bank of the same country we are safe in saying that it will not follow far.

What commerce will do for a country is well known by the growth of England. With an area scarcely larger than the state of New York, England through her foreign commerce has become the wealthiest nation in the world. She has scarcely a bank or a bank branch which is not directly connected with one or another of the great Anglo-Oriental banks. In all the advertisements of these Oriental banks a long list of domestic banks is given, and in many other ways a community of interest is established which results in

bringing the Oriental bank and the home bank, and (what is of more importance) the customers of both, into very close and sympathetic reciprocal relations, which in their results are enormously stimulating to international commerce. If the merchant in Sheffield, England, wishes to open a market for his goods in Hongkong, he obtains the most reliable and confidential information through the medium of his bank and its associated institution in Hongkong, and in every way conceivable his business is promoted. The services which the home bank, through its foreign branches, renders to the home producer are far superior to those which are offered by agencies in this country.

But England's hold on the Orient, although not to be easily lessened, is not, so far as we of this country are concerned, an insurmountable obstacle. While, by reason of the long-established relations of English houses, that country's Oriental commerce is now in the lead, it must be borne in mind that the early completion of our cable to Manila will cut in half the present cable distance, and thus add to the advantage of our geographical position, that of much lower cable rates. If it be true that American merchants and manufacturers are entering the field with Great Britain and Germany and successfully wresting from them not only the other European markets but their own domestic trade, they need not fear competition in distant countries where their rivals are working at a far longer range than they. With the banks of this country joining forces and pursuing the policy hitherto so successfully followed by England, every bank in the country has the means of being of very great service in developing the business of its clients and in adding to its own profits.

This development of foreign commerce will benefit the American banker in more ways than one. It will do so—

First. As has been shown above, in the increased and sustained activity of the commercial life of the community which he serves.

Second. The American banker who is engaged in this kind of business will be benefited by having his assets in more liquid form. When the manufacturer in this country sells his products in our markets, it frequently happens that he requires almost continual assistance from his banker, owing to his inability to realize on his sales until after the expiration of the term of credit which usage de-

mands be granted to his customers. A large percentage of the bank's bills receivable are thus made up of unsecured commercial paper upon which, in time of stringency, the bank could not realize quickly. When, however, the sales of the manufacturer are to foreign customers, they become the basis for bills of exchange, which are accompanied by bills of lading, insurance policies, etc., covering the shipment of the goods—the accompanying papers being of such a nature as to give the purchaser of the bill a lien upon the goods. These bills, when drawn in accordance with the well-established usage, are readily sold in London, Paris, and other great money centres. The banker is thus placed in the position of being able to carry them in his discounts, or of realizing upon them at a day's notice, if he desires to do so, for the purpose of increasing his reserve.

Third. "Foreign commerce benefits the American banker" by furnishing for the funds in his hands a legitimate field for use, and thereby lessening the temptation to enter the field of speculative capitalization. As the commerce of a nation increases the number of current bills of exchange increases correspondingly. These offer to the banker an ever-present legitimate investment of far greater safety than the average commercial paper and, as I have already said, are susceptible of the quickest realization. A bank, whether domestic or international, that is engaged in supplying the financial needs created by growing foreign commerce should be a purely mercantile bank, and its funds being fully required in facilitating trade, it cannot be in any way connected with the floating of industrial enterprises, or with the placing of their resultant securities.

In summing up, you will agree with me that the development of our banks is intimately associated with the commercial future of the country and that with our rapidly growing wealth the best method of utilizing the country's surplus funds, so that they may serve as a valuable lever with which to move the world's commerce to and from our shores, is one of the most important economic questions of the day.

Up to the present time our domestic and the European trade which we have developed, have furnished sufficient outlet for our activities. It is so no longer. Our foreign commerce to-day, in certain staples, is of such importance to us that legislation abroad

which would affect it adversely would cause acute financial distress in this country. For this reason, even though the enactment of such legislation seems improbable, we should be swift to seize the opportunity to open other markets, to the end that if some outlet should be closed there would yet remain others sufficient to our needs.

There is no doubt that the commerce of the Orient, great as it is to-day, will be enormously increased in the near future under the stimulus of American capital, American methods, and American brains, and that as a result we shall see our country pass through an experience through which Great Britain has already passed: namely, that when a country takes up on a large scale the development of its commerce with distant lands, there results a marvelous expansion of foreign trade, which increase many-fold the nation's domestic capital and profits.

BANKING CONDITIONS IN WALL STREET

ADDRESS DELIVERED BY THOMAS F. WOODLOCK, OF NEW YORK CITY, BEFORE THE MINNESOTA BANKERS' ASSOCIATION, AT LAKE MINNETONKA, JUNE, 1904.

As commercial bankers you will readily understand when I remind you that in the industrial and commercial life of this country the ultimate function of commercial banking is very much the same as that of the machinery of transportation—viz., to facilitate the movement and exchange of commodities of general use. It takes more than rails, cars, and locomotives nowadays to move freight from place to place; it takes credit, and banks are the collectors, sellers, and distributors of credit. Last year the railroads of the United States transported about 1,100,000,000 tons of freight, and banking credit was practically as necessary to the movement of this freight as were the railroads themselves.

The process of exchange of commodities is accomplished by a constant barter of commodities for credit and credit for commodities. Credit circulates like the blood through all the veins and arteries of a civilized community, and the banks, indeed, may be called the veins and arteries of the country. The bank gathers up credit from a multiplicity of sources, and masses it for mobilization in detach-

ments much as troops are massed. It then distributes it where it is needed; that is, to those who wish to borrow. The seller of commodities acquires credit through the sale, and this credit, through the bank, is made available to the buyer. Not until commodities have finally passed from the hands of the original producer to those of the ultimate consumer does the bank cease its function. At all intermediate stages it has work to do in the merchandising of the credit.

The movement of commodities from producer to consumer being the predominant function of purely commercial banking, it is clear that, conducted with ordinary discretion and care, banking ought to be the safest and soundest business that anyone could desire; for commodities are, after all, the only things that are really wealth. You remember the old legend of King Midas, who by his touch converted everything into gold. At first sight, he might appear to be the very type of a rich man; but when you consider the extremely limited use to which gold can be put, aside from its currency use, and when you consider that whatever commodities King Midas touched instantly became gold, you will admit that, of all men on this earth, he was the poorest. Nothing is more convertible, in the long run, than food, for nothing is of more universal use. What kind of collateral could be better than grain or cattle paper, from this point of view? Last October, when we had serious trouble in Pittsburg and Baltimore, I called upon Mr. Forgan, the distinguished president of the First National Bank of Chicago, to inquire of him how things were with Chicago banks. He put a new thought into my narrow Wall Street mind when he answered me that the Chicago banks were lending their money on the best collateral in the world—viz., grain and provisions; and that therefore they were all right. After all, it is only by convertibility into food, fuel, clothing, and shelter that anything becomes of value. Gold is wealth because of its convertibility; and, in the same way, credit is wealth.

The bank merchandises credit, buying from the depositors and paying them, sometimes in interest and facilities. It sells to the borrower, and makes its profits between the two. It stands ready at all times, at all events in theory, to pay its depositors or to make fresh loans. The whole "law and the prophets" of banking may be summed up in one thing—viz., convertibility of assets, or, in other

words, security of loans. So far as the banks of the country are concerned, and particularly the banks outside of the central reserve cities, their loans are made mainly for use in transportation and exchange of commodities. There are, in round numbers, eleven thousand banks in the United States, taking national and state banks together (excluding savings banks, which are essentially investment companies), and these banks have approximately $5,000,000,000 of loans outstanding. These loans would probably consist of:

Loans on real estate and collateral securities.....	$1,750,000,000
Commercial credits............................	3,250,000,000

If anything, I have overstated the amount of collateral and real-estate loans in this estimate. In Minnesota alone the statement would be about as follows:

Loans on real estate and collateral securities......	$21,000,000
Commercial credits................................	94,000,000
Total	$115,000,000

Thus, as regards all the banks of the United States, 65 per cent. of the loans would be commercial credits mainly employed in the transportation and exchange of commodities, while in the case of Minnesota 80 per cent. of the loans would be of this kind. As everybody knows, the bank is usually synchronous in its appearance with the railroad in a new town, and the church, the school, and the newspaper are usually close upon their heels.

In brief, then, the function of commercial banking is to facilitate the production, transportation, and distribution of commodities of general use through all the stages that lie between the original producer and the ultimate consumer. In New York, and more particularly in Wall Street, our banks perform a different function. They conduct, in a word, a financial banking business, which does for property other than commodities what commercial banking does for commodities. Financial banking facilitates the transportation of property through all its metamorphoses from the hands of one owner to those of another. Financial banks merchandise credit just as commercial banks do; but, of course, a different set of problems arises.

This distinction between commercial and financial banking is very simple. So is the principle of finance itself. If you come to

think of it, the art of finance consists in the transfer of property from hand to hand, which, in the generality of cases, means the supplying of investments and the collection of capital for investment. As conducted nowadays, it means, in fact, the manufacture or collection of securities and their sale to investors. By investors I mean those who purchase to hold for investment, as contrasted with those who are traders, or speculators, because they purchase for quick re-sale. You are, of course, entirely familiar with the nature of securities, which is, in the main, twofold. Securities are either evidences of title or equity, or evidence of debt. I need not waste time in describing them in detail, further than to remind you that they exist in every shape, manner, and form, and are of every grade of value. Their variety is almost infinite.

In order to explain the principal operations of financial banking, I shall take a hypothetical case of the very simplest form, and I think you will be able to follow the various stages of the operation. Let us suppose a bank starting business with a capital of $1,000,000 and a surplus paid in of $1,000,000. The bank is able to secure 100 depositors, each of whom has 100,000, making a total of $10,000,000 on deposit account. It loans to 90 individual manufacturers of cigars the sum of $100,000 each for use in their business, so that its loans amount to $9,000,000. The bank's condition is then expressed in the following statement of assets and liabilities:

ASSETS

Loans	$9,000,000
Cash in vaults	3,000,000
Total	$12,000,000

LIABILITIES

Deposit account	$10,000,000
Capital and surplus	2,000,000
Total	$12,000,000

The bank is doing a commercial business, as it is lending money to cigar manufacturers on commercial paper and notes. Some of this money it is lending on call, and some on time, so that it may be able to meet any demands that its depositors may make upon it. Among the directors of the bank is a financier, or promoter, who is cognizant of the business of the bank. The idea occurs to him that

a trust can be formed of the cigar manufacturers, from which a promotion profit can be extracted. He sends his agents to investigate the condition of the various manufacturers' plants, and the information that he secures confirms his original idea. He thereupon secures an option from each of the manufacturers to purchase his business at a certain price. The price is fixed upon such a basis that the borrowings of the manufacturers at the bank are to be paid off, and each manufacturer is to have stock in the new trust. The financier proposed a capitalization of $10,000,000 bonds, $10,000,000 preferred, and $10,000,000 common stock, and it is understood that the bonds are to be sold to him at 90 cents on the dollar; thus providing the $9,000,000 necessary to pay off the borrowings at the bank; and he has, further, the option of buying the stocks of the new trust at 60 cents on the dollar for the preferred stock, and 30 cents on the dollar for the common stock. He is bound, therefore, to provide $9,000,000 of cash, for which he gets $10,000,000 bonds, and he has the right of putting up $9,000,000 more cash to get all the stocks of the company to be formed.

He organizes as a syndicate to take the bonds at 90, agreeing with the syndicate that they shall ultimately be sold to the public at par; thus netting a profit of $1,000,000 on the $10,000,000 bonds. Of this $1,000,000 he has to have $250,000 for himself, representing the compensation for his initial risk and trouble, the rest being divided pro rata among the members of the syndicate. The syndicate is formed. On a certain day payment is to be made to the cigar manufacturers, who will receive $10,000,000 preferred stock and $10,000,000 common stock in the new company, and have their loan at bank, amounting to $9,000,000, paid off. On paying off these loans the syndicate will have $10,000,000 bonds of the new company. Inasmuch as the bank is going to be paid its $9,000,000 of commercial borrowings, it has $9,000,000 to loan the syndicate, and accordingly the financier arranges to borrow $9,000,000 from the bank for the syndicate, which puts up as collateral securities as margin as the bank may desire, these securities, of course, being taken from the syndicate's own resources. The arrangement is satisfactory, and on the day appointed the deal takes place. The bank's condition is then precisely similar to what it was, except that, instead of lending $9,000,000 to commercial borrowers on their own

notes, it is lending $9,000,000 on collateral securities to the syndicate. The former manufacturers are now stockholders in the corporation, subject to the optional right of the syndicate to purchase their holdings at an aggregate sum of $9,000,000.

The times being propitious, the financier decides that the public will take the $10,000,000 bonds at par, and arrangements are made for a public offering at that price on a given day. The issue is extensively advertised, and it attracts the notice of the bank's depositors, 100 in number, each having $100,000 to his credit. Each depositor makes up his mind that the bonds are a good thing, and each subscribes for $100,000, being the amount of his idle money on deposit. The result is that the syndicate has sold its $10,000,000 bonds to realize $10,000,000, and, having paid but $9,000,000 therefor, it has a profit of $1,000,000. If the transaction were closed at this point, the $9,000,000 loaned would disappear and the original $10,000,000 deposited would disappear, and there would be left $1,000,000 deposits, representing the syndicate's profit, and the bank would have $3,000,000 cash, representing its own capital and surplus and this $1,000,000 deposit. The bonds, however, have gone so well that the financier decides that it is wise for him to exercise his option on the company's stock, and he determines to buy from the stockholders, under his option, $10,000,000 of the preferred stock at 60, and $10,000,000 of the common stock at 30, the total cost being $9,000,000. He arranges with the bank again to borrow $9,000,000, this time on the stock as collateral, with such other margin as the bank may require, as in the case of the bonds. When this operation is completed, the bank's position is as follows:

LIABILITIES

Deposit to credit of syndicate	$1,000,000
Deposits to credit of former stockholders	9,000,000
Capital and surplus	2,000,000
Total	$12,000,000

ASSETS

Loans to syndicate on stocks	$9,000,000
Cash in vaults	3,000,000
Total	$12,000,000

The task of the syndicate now is to sell the stocks thus purchased

at a profit. This involves the usual practice of "making a market" for them, probably on the curb market. Transactions are made of what is called a "wash" character, at continually advancing quotations, between brokers employed by the syndicate. I regret to state that the financier will probably endeavor to have judicious paragraphs inserted in newspapers calling attention to the great merits of these stocks. Some newspapers will print them; others will not. Finally, quotations for the preferred stock being marked up to 65, and quotations for the common stock being marked up to 35, the stirrings of cupidity make themselves felt in the hearts of the gentlemen who took the company's bonds for investment. These gentlemen are convinced that the time has arrived for them to take a little speculative "flyer" in the company's stock, and, strange to relate, each one elects to buy for himself on speculation 1,000 shares of the preferred stock at 65 and 1,000 shares of the common stock at 35. Being speculators in this instance, they have to borrow money in order to pay for the stocks, and as each one has $100,000 bonds of the new company, each has plenty of margin with which to make a loan. Consequently, they go to the bank and borrow $100,000 each on 1,000 shares of preferred stock and 1,000 shares of common stock, with, say, $30,000 of bonds as margin; the syndicate, having sold the stock, which cost it $9,000,000, to speculators for $10,000,000, making another profit of $1,000,000 on the operation, and besides being enabled to pay off its borrowing at the bank. After this operation the position of the bank is as follows:

LIABILITIES	
Deposits of the syndicate	$2,000,000
Deposits of former stockholders	9,000,000
Capital and surplus	2,000,000
Total	$13,000,000
ASSETS	
Loans to speculators on company's stocks and bonds	$10,000,000
Cash in vaults	3,000,000
Total	$13,000,000

The syndicate has cleaned up $2,000,000 on the operation and is content. The original cigar manufacturers have not merely sold their business to the trust, but have sold their stock-holdings in the trust, and are now plain capitalists with $9,000,000 to their credit

at the bank. The original depositors are now speculators in the company's stocks and investors in the company's bonds. Incidentally, they are borrowers of $10,000,000.

In a little while the cigar trust falls upon evil days, and the dividend on the common stock, which was started on a 4 per cent. basis, has to be suspended. The speculators become alarmed, and endeavor to sell their speculative holdings. The price of the preferred stock, which cost them 65, falls to 55; and the price of the common stock, which cost them 35, falls to 25. The original stockholders see an opportunity to purchase their holdings for less money than they received when they sold them, and they conclude to re-purchase at 55 and 25, making a total cost of $8,000,000. They have $9,000,000 on deposit at the bank, and they use $8,000,000 of this to buy back the stocks from the speculators, who have borrowed $10,000,000 on them. The speculators are thus enabled to pay off $8,000,000 of their $10,000,000 borrowings, leaving $2,000,000 still borrowed on security of $3,000,000 of the company's bonds. When this operation is completed, the bank's position is as follows:

LIABILITIES	
Deposit to credit of syndicate	$2,000,000
Deposits remaining of former stockholders	1,000,000
Capital and surplus	2,000,000
Total	$5,000,000
ASSETS	
Loans to speculators on bonds	$2,000,000
Cash in vaults	3,000,000
Total	$5,000,000

The affairs of the trust go from bad to worse, and there is a question of its ability to continue interest payments. The price of the bonds falls materially, and the bank becomes anxious. It calls upon the speculators for more margin, and gets from each another $10,000 bonds, being $4,000,000 in all, to secure loans of $2,000,000. The price of the bonds falls further, and the bank demands payment of the loans. The financier, having taken pains at the outset to inform himself of the true conditions, and knowing that the depression in the cigar trust's affairs is but temporary, decides that it would be a good plan for his syndicate to make a bid to the bor-

rowers of 50 cents on the dollar for $4,000,000 of the bonds, this being just enough to enable them to pay off their borrowings at the bank, and this being exactly the amount of the deposit to the syndicate's credit, representing their profits on the business. The speculators accept his offer. He buys for his syndicate $4,000,000 of the bonds at 50 cents on the dollar. The speculators are able to pay off the $2,000,000 they owe at the bank, the syndicate drawing on its $2,000,000 deposit to pay for the bonds. The bank's position, then, stands as follows:

LIABILITIES

Deposit of former stockholders	$1,000,000
Capital and surplus	2,000,000
Total	$3,000,000

ASSETS

Cash on hand	$3,000,000

The original stockholders think they need a little ready money on hand, and they draw out their deposits in cash, leaving the bank exactly where it started—viz., with $2,000,000 cash in its vaults, representing its paid-up capital and surplus. I have omitted to take any account of the matter of interest, so as not unnecessarily to complicate the figures, and it is only a matter of detail anyhow.

Observe what has occurred. Ninety separate and distinct borrowers, each borrowing $100,000, and each owning a cigar manufacturing business, have been formed into a corporation. One hundred individual depositors of $100,000 each, making $10,000,000 in all, have become investors in the bonds of the corporation, and a syndicate headed by a financier has extracted $2,000,000 profit from the whole operation. If we suppose the company's bonds again to become worth par, the "profit and loss" of the operation will be a gain to the syndicate of $4,000,000, as it invested its $2,000,000 profit in bonds at 50 cents on the dollar, which $4,000,000 has been lost by the speculators who originally had $10,000,000 deposits in the bank, and have only $6,000,000 of bonds. The position of the individual borrowers at the start is exactly the same, inasmuch as, while they, as stockholders of the company, are now borrowing $10,000,000 on the company's bonds, in place of the $9,000,000 they originally borrowed on their own notes, they have secured $1,000,000 in cash, which accounts for the difference.

It is important to note the factors that may be operative so far as the bank is concerned at the various stages of the whole business. While the bank is doing a commercial business, it must, of course, so arrange its commercial loans as to have maturities falling in all the time, and thus be able to pay its depositors. I need not enlarge upon this aspect, as, of course, it is very familiar to you as commercial bankers. At the second stage of the operation, however, where the bank is lending on collateral securities, the problem is a little different. Its ability to meet a sudden call on its depositors depends on the ability of the syndicate to pay its loans. The syndicate can pay its loans only by being able to sell securities for cash, either the collateral securities upon which it is borrowing or such other securities as it may have in its resources. Somebody must be able to buy the securities from the syndicate for cash, or the syndicate cannot pay its loans. It is evident that a sale to speculators merely will not improve the case, unless the speculators can borrow money elsewhere than at the bank, because, if the speculators had to borrow from the bank, there would simply be a shifting of loans from one borrower to another, which would not provide the means to pay depositors. Therefore, if the depositors of a financial bank want their money, the collateral upon which the bank is lending must be marketable to somebody who can provide the money for the depositors. Convertibility of loans is just as much the first requisite of financial banking as it is of commercial banking, but you will readily understand that the sale of securities to investors is quite a different thing from the sale of commodities to consumers. Where a bank is lending on speculative securities, convertibility in the full sense of the word is more difficult than where it is lending on strictly investment securities. First-class railroad bonds, for instance, can always be sold to investors at a price, except in times of extraordinary monetary stringency. Even then they can be sold, because they are the first things that an investor will buy. Stocks of a speculative character cannot always be sold. There comes a time, about once in so often, when we have a panic. Such a time, for example, was May 9, 1901. The panic at that time came in the forenoon, and there was time for the rally before the close of the market, the closing prices being, of course, the basis for settlement. Had the panic come at two o'clock in the afternoon, and had the

arket closed at the panic prices, there would have been a record f insolvencies such as never has been seen. The banks would, of ourse, have been very heavy losers all around.

The hypothetical case that we have considered contains the eneral principles of financial banking, and, in fact, of finance as it conducted in Wall Street. The banking business of Wall Street carried on by two classes of institutions—viz., the Clearing House anks and the trust companies. These two classes, together with a ew private lenders and the life-insurance companies, furnish the redit in Wall Street. The volume of credit of all is probably in the eighborhood of at least $1,500,000,000. It is impossible to give efinite figures at a certain time, because the trust companies do not eport their operations except twice a year, to the State Banking epartment. You are, of course, familiar with the relations of the ust companies to the banks. Trust companies do not carry a egular cash reserve,[1] as the banks do, but use the banks as depositries of their surplus funds, upon which they obtain interest much s the country banks do from their reserve agents. The result of is is that the cash reserves of the associated banks have to support, ot merely the operations of the banks themselves, but also the perations of the trust companies. A trust company, for instance, hich has $20,000,000 deposits, will lend perhaps $15,000,000 of is amount directly, and will deposit the other $5,000,000 with one f the Clearing House banks. The cash in its own vaults will consist of perhaps its capital and surplus, and no more. On a given ay the weekly bank statement will show, for example, as follows:

Deposits	$1,100,000,000
Loans	950,000,000
Cash	275,000,000

These figures show only the operations of the Clearing House anks. At the same time the trust companies will have:

Deposits	$500,000,000
Loans	375,000,000
Cash	25,000,000

nd they will have on deposit with the banks $125,000,000, the cash n their vaults representing their capital and surplus. Now, when scertaining the true position, we have to combine the two statements, eliminating the duplication in deposits caused by the trust

[1] At present the laws of the State of New York require the maintenance f a regular cash reserve.

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companies redepositing with the banks, and we should get a consolidated statement, as follows:

Deposits	$1,475,000,000
Loans	1,325,000,000
Cash	300,000,000

This would represent the actual condition of affairs, as far as the public is concerned, taking the trust companies and banks together. I need not pause here to criticise the bank statement at any length, but it is easy to see how useless it is as an indication of the true conditions. For example, in times of very easy money the tendency will be for the trust companies, instead of lending all their deposits, or nearly all, themselves, to redeposit a considerable proportion with the banks at interest. When money becomes more active, the trust companies will aim to make their own loans, and secure all the benefit therefrom, and, consequently, they will draw down their deposits with the banks. Take the bank statement as I gave it a moment ago—viz., deposits $1,100,000,000, and loans $950,000,000. The banks are holding $125,000,000 of trust-company deposits. The money rate goes up, and the trust companies lend $50,000,000 of this $125,000,000, thus reducing their bank deposits by so much. They take this business away from the banks, and the bank's statement shows $50,000,000 less deposits and $50,000,000 less loans, with a consequent increase of $12,500,000 in surplus reserve; whereas, in reality, the volume of credit outstanding is the same, and the cash reserve is the same, there simply having been a transfer of accounts from the reporting arbitrage banks to the non-reporting trust companies. Under such conditions the bank statement is not merely worthless, but absolutely misleading. If, however, it were to include a separate statement every week of trust-company deposits, the changes in that item would give a very fair indication of what was going on. Everybody would know that, if trust-company deposits with banks went down $50,000,000, trust-company loans had probably increased that amount, offsetting a corresponding increase in bank loans. Unfortunately, the tendency in New York is not toward increasing the information available to the public. New York is the principal reserve city in the United States, and as such it has to take up and let out what might be called the currency slack at certain times of the year. Wall Street banks

have to ship anywhere from $30,000,000 to $40,000,000 cash west and south every fall, which cash comes back in the fall, winter, and spring. This strain necessarily falls upon the financial community, and is, of course, a tremendous factor in speculation. It must not be forgotten that the line between finance and speculation is excessively thin, and by no means straight. There are very few financial operations that have not a very large infusion of speculation in them. Financial banking must be conducted with an eye on the stock ticker and an ear always open to the slightest whispers of the market.

Our banks are very largely directed by men who are themselves prominent in the management of railroad and industrial companies, and by men who are thoroughly versed in lore of the stock market. New York bankers are, with few exceptions, steeped in the atmosphere of stock-market business, and the ticker takes a good deal of their attention. I do not mean to imply that they are speculators, in any sense of the word, as individuals. What I mean is that the stock market reflects those activities upon which the greater part of Wall Street banking depends. The stock market is the one place where the banks' borrowers can get money if they have to, and to the stock market they must go when depositors have to be paid. Taking the Wall Street banking situation as a whole, in time of stress, when the country banks call home their money, there is just one thing to be done, and that is liquidation in the security market. By liquidation I mean the sale of securities to ultimate consumers; that is, to ultimate investors. In the early fall of 1902, as is now evident, the situation in Wall Street was excessively dangerous. Currency was called for west and south, loans were heavily extended in all directions, and securities were high. Secretary Shaw saved the situation, but saved it only by a hair's breadth. Wall Street got through the pinch, but it took a year of liquidation and a 45-point decline in securities, equal to 33 per cent. of their value, to restore sound credit conditions. Had anything slipped a cog in the fall of 1902, we should surely have had a repetition of the May panic, which would probably have been more lasting and far more harmful in its effects, because more lasting. Ultimate consumers had to be found for the securities upon which the banks were lending money, but instead of having to find them in a hurry, which means a panic,

Wall Street was able to look for them in a more leisurely fashion, which brought about the long decline of 1903.

Speculation, as a word, is not in good repute. It has an unpleasant sound in people's ears, because of the abuses committed in its name. Nevertheless, speculation is one of the strongest and most constant factors in financial banking, and, therefore, in Wall Street banking. When you remember this, and when you remember, furthermore, that New York is the principal storehouse of the country's cash for a great part of the year, you will realize that the problems that present themselves to the Wall Street banker in the course of his business are very different from those that ordinarily fall to the commercial banker for solution. Of course, the great requisite in collateral security is marketability, and in this respect Erie common is as good a collateral as Chicago & Northwestern, if not better. Still, great mistakes can be made in judging convertible collateral. At the close of the boom period many of the credit institutions of Wall Street were choked up to an inordinate extent with syndicate borrowings representing unmarketable, and therefore unavailable, collateral. No one knows the full extent of this kind of thing, but it must have been very large in 1902. Enormous losses have been made in underwriting since that time, and the scars have been visible to anyone who took the trouble to read carefully the New York *Banking Report* for 1902 and 1903. Happily, liquidation has been accomplished to an extent that removes the element of danger, and the banking position to-day must be accounted sound, so far as Wall Street is concerned.

I am conscious, and disagreeably so, that I have been able to touch only in a most imperfect fashion upon Wall Street banking conditions, and I fear that I have done little more than recapitulate things familiar to all. The one thing that stands out most prominent in my judgment, with reference to Wall Street banking, is the danger of the concentration of banking power in the hands of a few great speculative interests. We have certain clearly defined tendencies in Wall Street, the ultimate effect of which is likely to be the creation of two or three powerful groups of banks. There is, for example, the so-called Standard Oil group of banks, headed by the National City; there is the so-called Morgan Life Insurance group, with the National Bank of Commerce and the First National

Bank at its head. These two groups contain many of the most powerful banks in New York City, and together account for a very large proportion of the total volume of credit at the disposal of the public. To the credit of these banks be it said that the immense power in the hands of their managers has not been abused so far, and probably will not be abused by those who now hold it. But the connection between the managements of the banks in New York City and the great financial and speculative interests is very close, and if ever we have serious banking trouble, it will come from this fact. I suppose that things cannot be different, but one cannot help wishing that the purely commercial, as distinguished from the purely financial, element were more prominent in the management of our great banks. Human nature is weak, and human nature is very fallible. Speculation is a strong temptation. At the best, financial banking is attended with more dangers than commercial banking. These dangers are increased by the temptation. So far, the history of Wall Street banking, though marked by some black spots, is, in the main, creditable. We may hope it will always be so; but our hopes need not blind us so far as the dangers that always threaten are concerned.

THE RELATION OF THE BANKING CAPITAL TO THE VOLUME OF BUSINESS

ADDRESS DELIVERED BY FRANK L. MCVEY, PROFESSOR OF ECONOMICS IN THE UNIVERSITY OF MINNESOTA, BEFORE THE MINNESOTA BANKERS' ASSOCIATION, AT LAKE MINNETONKA, JUNE, 1905.

THE movement toward increased volume of business in commercial and manufacturing fields has not escaped your attention. The business man tests his efficiency by the rotation of his capital to his total business; he wants to reach a big ratio; but, though this is true, it is not to be forgotten that he constantly supplements his capital by issues of bonds or by loans on commercial paper. The latter method reduces capital cost to the minimum, in that he pays for the use of capital only during the season in which he needs it. His ability to do this, however, depends upon the bank and banker;

upon their ability to expand their loans and discount as he demands them, and, incidentally, upon his ability to offer collateral and commercial paper of a high quality. He borrows to make a profit; the bank lends for the same reason. Any curtailment of his ability to borrow by the inability of the bank to expand its sale of credit accounts reduces the business efficiency of our business man and affects the prosperity of the community.

This statement may be reinforced by putting the matter somewhat differently. A banker is engaged in selling money short and agreeing to make delivery of it upon demand. In doing this he sells credit accounts for commercial paper and agrees to deliver money upon demand to the limit of the credit account or deposit. This, then, brings to view our interest in the relation of banking capital to volume of business, and raises the query: How far can the banker extend his sale of credit accounts and still maintain ability to deliver money upon demand without affecting the borrowing of the community, or, in fact, without actually crippling its business?

It might be urged that the bank is under no obligations to meet this demand. Under our system, however, that elasticity of purchasing power so necessary to business must come from the banks. We have no great central government bank. The United States, providing legal money, final power of payment, after a long and bitter experience, in which the distinction was necessarily made between what might be called "credit money" and "credit accounts," decided that the issue of money should be taken over as one of its essential duties. This left the banks with the functions of making loans and discounts and of receiving deposits. Mr. Dawes recently stated that the bank accounts used by the business community amounted to $9,000,000,000, as against the $2,500,000,000 of gold, silver, notes, and subsidiary coins issued by the government. Here, then, is clear indication of the function of banks.

The community, using the term to represent the business and commercial interests of the nation, wants three things relative to this volume of bank accounts. These are: first, elasticity of credits; second, ease of redemption in money; third, redemption of such accounts upon demand at all times. The ability of banks to meet this demand rests fundamentally upon the amount of its capital equipment and the form of its investment; hence the rapid increase

of volume of business materially influences, not only the demand upon the banks for actual money, but their power of providing the actual money. Our inquiry therefore takes the form of this question: How far can banks increase loans and discounts without increase of capital, and in what form must such capital be held in order to give the greatest elasticity of credit accounts?

The sole test of the bank's capitalization should be the ability to meet every money demand upon presentation. As has been suggested, a business house can supplement its capital by selling bonds, using the proceeds for increase of equipment, or by borrowing the necessary purchasing power from a bank to meet current expenses. Such a course is not open to a bank in good standing, for a bank must furnish money upon demand. It cannot in justice to its customers borrow continuously for the purpose of maintaining its equipment. Neither, for that matter, can a business house do this; but the latter can, however, meet its obligation by postponing payment through the sale of commercial paper. The bank must furnish money through the purchase of a credit account from the bank. Hence the principal element in the bank's capitalization should be that part, sometimes called redemption equipment.

The redemption equipment consists of money reserves, balances with other banks, unencumbered securities, loans to reserve agents, less amounts due to such agents, and the margin of securities over incumbrances, sometimes amounting to a considerable sum. In addition to the redemption equipment, there are certain unavailable capital investments—unavailable from the point of view of immediately available cash, in that they are not convertible into money. These investments consist of banking house, real estate, and the margins bound up in bonds deposited for note circulation, bonds held by the federal government against deposits, premiums on bonds, and the 5 per cent. redemption fund.

Returning to the redemption equipment, it will at once appear that balances with other banks under the reserve system and loans to reserve agents may not be available at once for use in meeting money demands. The supposition is that such moneys are in their nature invested reserve; but in actual banking operation they are a claim against other banks, payable upon demand, against which are held a minimum money reserve required by law. It is not, there-

fore, always possible to count upon loans to reserve agents as money available for expansion of loans and discounts. In ordinary conditions the money is paid upon demand; but during times of stress the payment is often provokingly slow. Inquiry concerning the possession of bonds may show that the bank has acquired them through hypothecation or by underwriting. In such instances there may have been a reduction in the principal. Capital impairment of one kind or another may therefore have reduced the capitalization of banks, so far as the redemption equipment is concerned, to the minimum required by law, and, what is still more serious, fixed the invested capital in such forms that it is not possible to realize money, in the actual cash sense, upon demand. While this condition of affairs exists the power of expanding credits has been materially reduced.

If the meaning of this paper is not now revealed, it may be made clearer by a quotation from Mr. Cleveland's book, *The Bank and the Treasury*. He says: "The commercial bank is not organized for direct capital investment. It is capitalized for the purpose of supporting its own credit obligations; and these credit obligations in turn are used as a means of purchasing the current liabilities of other business concerns." (P. 15.) In other words, the support of its own credit obligations requires the possession of money and the ownership of such collateral as will make it possible, in times of stress or of increased demand for the credit obligations of the bank, to secure by hypothecation or sale of its invested reserve all money necessary to meet the demands made upon it. In this connection several axioms may be laid down relative to banking capital. First, a bank must have an adequate capital, determined, not by a rule of thumb, but by the demands of the community for credit accounts; second, such capital must be in money, and invested securities easily turned into money by hypothecation or sale; third, the capital of a bank is the real support of its credit obligation.

It is at this point the question may be asked: How far does the actual situation conform to these requirements? According to the report of the Comptroller of the Currency, the deposit liabilities of national banks on which a reserve is required was, November 25, 1902, $3,705,217,312. Against this amount was held in cash and in funds with reserve agents and the 5 per cent. redemption fund,

$987,074,218, or 26.24 per cent. The legal reserve was $817,981,-481, or but 22.08 per cent. On September 9, 1903, the deposit liabilities had increased to $3,863,512,112, against which the banks held $850,762,184, or 22.02 per cent. The percentage of all available funds to deposit liabilities ranged from 26.25 per cent. on April 9, 1902, to a maximum of 27.70 per cent. on February 6, 1903.

Taking the banks of New York City during the present year, we have an example of fluctuating reserve in its effect upon bank deposits. On March 18, 1905, the banks of New York City held a surplus reserve of $5,154,175, and loans during the week previous declined $5,241,900, and the deposits $13,227,700. On May 20 the surplus reserve was $8,219,995, and the loans had increased over the previous week $20,709,900, and the deposits had grown by the figure of $14,932,000. This rapid contraction and expansion, commendable as it would have been if in conformity to the wishes of the community, was in reality at its expense, as the banks were forced to reduce loans in order to increase their reserves.

In the matter of capital, the 4,601 national banks held in capital, surplus, and undivided profits, $1,201,148,883, or $261,052 per bank, on September 15, 1902. Nearly three years later, March 4, 1905, the 5,587 national banks held $1,386,043,600 in capital, surplus, and undivided profits, or $248,083 per bank. Going back to December 9, 1893, the situation was as follows: capital, undivided profits, and surplus, $1,028,841,230, or $273,029 capital for each of the 3,787 national banks then in existence. Now, comparing these figures with the credit accounts or individual deposits, omitting government deposits that were fully protected by deposit of collateral, we have the following: December 19, 1893, 3,787 banks have $1,029,841,230 capital investment and $1,539,399,795 individual deposits; September 15, 1902, 4,601 banks have a capital investment of $1,201,148,883 and $3,209,273,894 individual deposits; March 14, 1905, 5,587 banks held $1,386,043,600 and $3,777,474,006 individual deposits. Putting it on the basis of individual banks, we have the following: In 1893 the capital per bank was $273,029 and $406,231 of deposits; in 1902 the capital per bank was $261,062 and $697,516 of deposits; in 1905 the capital was $248,083, or $675,630 of deposits. Thus from 1893 to 1902 there had been a decline of $11,967 in the capital per bank and an increase of $285,000 in deposit obligations; from 1902 to

1905 the capital per bank declined $12,978 per bank below the figures of 1902; the deposits declined to the amount of $21,886.

Legal reserves were held by the national banks in 1893 to the amount of $414,135,407, or $109,080 per bank; in 1902 the reserve was $507,993,738, or $110,409 per bank; in 1905 the reserve was $641,153,633, or $120,288. Again making the comparison with previous figures, it appears that in 1893 the individual bank held $273,029 in capital, deposits of $406,231, and a reserve of $109,080; in 1902 the capital was $261,062, deposits $697,516, and reserve $110,409; in 1905 the capital was $248,083, deposits $675,630, and reserve $120,288. The 1902 period, as shown by these figures, was the high-water mark in the amount of credit obligations standing against banks, and the low-water point in capital and reserve. In other words, there is clearly shown here the marked tendency of banks to expand their credit account without an adequate increase of capital and reserve. Realizing this, the banks have attempted (and it is perhaps wiser to say the central reserve city banks) to increase their reserve and reduce their loans and discounts. This, however, is not the method to prevent disturbance. The difficulty is that the present demand obligations of banks are too large relative to their capital. Consequently, under present conditions, any attempt on the part of the banks to strengthen their position must be accomplished by reducing the accommodations of the banks and affecting, as a result, the purchasing power in the community. This is the end which is undesirable; it is not the end that can keep the banking business up to the requirements made upon it.

Elasticity of credit accounts therefore must rest upon a capital sufficiently large to meet all the demands made upon it. Such demand, however, varies from 16 to 30 per cent. of the average volume of credit accounts used as current funds. This would necessitate the holding of the reserves, unless some provision is made by which the banker could realize some return upon moneys held for reserves. Under present practice the bank makes a loan to reserve agents, expecting to recall the loan when it needs the funds for actual reserve purposes. This practice has developed into a system by which the surpluses of banks have been collected in a few large banks and the fluctuating money demand of the country falls upon them. This, to quote another, is a "condition which at times

deprives outside banks of the support of central banks, and, again, forces New York banks to resort to clearing-house certificates for settlement of money balances among themselves—a condition of financial paralysis to commercial enterprises." Again, the capital of the bank must be invested in actual "redemption equipment" to a greater degree than now practiced, nor can any reliance be had upon impaired capital in the form of real estate, banking houses, or the reserve loans made to other banks to meet this want. Such part of the equipment as is necessary should be held in cash, the remaining portion in selected investment, upon which the bank may increase its money holdings, either by sale or hypothecation. This makes possible an elasticity equal to any legitimate demand of the community; but, what is more to the point, an elasticity not dependent upon the financial difficulties prevailing in a distant money center, but fully in the hands of the banks of each locality.

Our banking system is a local banking system. Its history is a history of many banks, each meeting the wants of its special locality, while at the same time co-operating with the others. To continue to do this requires, as I believe has been clearly shown, a larger capitalization and more careful provision of both cash and invested reserves.

BANK CREDITS

ADDRESS DELIVERED BY JAMES G. CANNON, VICE-PRESIDENT OF THE FOURTH NATIONAL BANK OF NEW YORK CITY, BEFORE THE NEW JERSEY BANKERS' ASSOCIATION, AT ATLANTIC CITY, MARCH, 1905.

I HAVE chosen for my subject "Bank Credits," the same title I gave to an address delivered at Drexel Institute, Philadelphia, on November 17, 1892, a little over twelve years ago, at which time there were not more than a half-dozen credit departments in as many banks in the United States, and, as I stated in that address, during the entire period of the existence of the American Bankers' Association, from 1875 until that date, the subject of "Bank Credits" had never been discussed in a practical way by its members. Since that time, however, the subject has come up for discussion before many

state bankers' associations throughout the country, and the introduction of credit departments in banks has become very general.

On February 9, 1895, the executive committee of the New York State Bankers' Association adopted resolutions recommending to its members "that they request borrowers of money from their respective institutions to give them written statements over their signatures of their assets and liabilities, in such form as the committee on uniform statements of the various groups might recommend." Acting upon these resolutions, nearly all of the groups of the New York State Bankers' Association adopted uniform statement blanks, and the example set by that association has been followed by many associations in other states.

In 1898, the National Association of Credit Men, a large and powerful organization of nearly 3,000 members, after a year's investigation of the subject, adopted uniform statement blanks, which have ever since been widely employed.

On September 7, 1899, the American Bankers' Association, in convention assembled at Cleveland, Ohio, adopted a uniform property statement blank, to be supplied to its members, and thus placed the stamp of its approval upon the credit department for banks, at the same time instructing its secretary to set up in his office a model department, and to furnish information to its members regarding the workings of the same.

You might say that these efforts were practically the beginning of credit research, and as we trace the subject during the past twelve years and note the growth of these methods and the many difficulties which have been overcome, we certainly feel that something has been gained by the agitation and discussion of bank credits, and much good has been accomplished.

In an address in June, 1896, at the organization of the National Association of Credit Men, I stated: "Credit can hardly be classed among the sciences, and certainly it cannot be said to be an exact science, because it is not governed by any definite, fixed laws." But after years of study of this subject, I am beginning to feel that there are certain definite, fixed laws governing credit, and I am prepared to take a step forward to-day, designating it credit science, and later I hope to be able to show you some of its principles, its mechanism, and its guiding rules.

It is becoming evident to students of financial affairs that there is a gradual change of method in the buying and selling of commercial paper from that which obtained in former times. Borrowers no longer confine themselves to one place, but go where funds can be procured to the greatest advantage. Merchants in the smaller towns go away from home to borrow money, and bankers in smaller cities go away from home to procure investments. Often bankers do not feel that they can break the rate locally, but it frequently happens that they will send to the large money centres and buy the paper of their home merchants at a lower rate than they would feel that they could take the note for direct. One-eighth per cent. will take many a business man from home for his accommodation. The practice is growing for the banks in larger cities to buy commercial paper for their correspondents and in the face of these changes in method it becomes more and more imperative for bankers who handle commercial paper, and who are located in the large money centres, to be fully informed in the widest measure upon the credit of borrowers.

We have noted the beginnings of credit science; we have briefly traced its interesting and rapid development during the past twelve years, and we have marked the changes in methods which are calling for constantly improved ways and means of credit research. Let us take the measure of the credit science of to-day in a few words before we consider the problems and prospects of the future.

The corner-stone of credit science may be said to be the requiring from borrowers of statements of the conditions of their affairs. This has now become an accepted custom in the relation between banks and borrowers on commercial paper. It has come to be recognized that the practice is of value to both the bank and the borrower, and this may be considered the reason for its success. Furthermore, the making of statements oftentimes renders concerns themselves aware of weaknesses in their methods of operation, financial practices and results of business. The banker, having a substantial interest in the success of the borrower, may frequently give wholesome advice or timely warning from his wide experience in commercial affairs and his foresight in monetary matters. There is a distinct parallel in the results that have worked out from the practice of giving statements, to the results with which we are so familiar in the methods of the national banking system. Here statements of

conditions and bank examinations have resulted in wise improvement in our methods, in wholesome safeguarding of our funds, in conservative financing, and in general advantage. Again, there is a parallel in the results which have developed from the mutual relations of manufactures and the factory mutual insurance companies. Here the companies called for improvements in buildings and equipment, which have rendered fire a remote contingency. Whoever doubts the joint interest of such a movement has never experienced the paralyzing effect which a fire has upon the affairs of any concern. The statement of condition has come to stay, and is fundamental in credit matters.

But if the statement is the foundation of the credit structure, the credit department may be considered to be the superstructure. This division of the bank's operating mechanism may be said to be the clearing house for credit information, the headquarters for credit analysis, the storehouse of facts relating to those who are commercial borrowers of the bank's money. Our credit men are the watch-dogs of the bank's risks and the guardians of the investments made for its correspondents. The department must be manned by our most faithful, reliable, intelligent, tactful men, who must be capable of infinite pains, of inexhaustible patience, and of absolute loyalty. Their eyes and ears must be open to every contingency that no sign may go unheeded. They are compelled to walk in the ruts of routine and yet be pathfinders constantly. No man who works mechanically will develop into a successful credit man. The credit department should have an equipment commensurate with its importance. It should be the inner chamber in all respects. Recorded confidences should never be violated, and there should be no latch-string to this department. Its mechanism of blanks, files, vaults, and office fixtures should be perfectly adapted to its service, and every means which ingenuity can devise should be utilized to assist its work.

In our review of the credit science of to-day we have noted the universal custom of giving statements. We have glanced over the mechanism provided for the handling of these statements and correlated data, but the important feature of all credit science is: What is our interpretation of these statements? I wish to make clear my conviction that a statement which is not submitted to analysis is a menace. Because, first, if errors have been made, if

lack of judgment on the part of the management of the concern has been shown which is not brought to the attention of the borrower; if reckless methods have been indulged in or any dishonesty has been practiced, the very fact that a statement has been received and accepted by a banker either lulls into a sense of security the careless or heedless borrower, confirms the reckless financial habit, or establishes the dishonesty if such exists. I repeat, that an unanalyzed statement is worse than no statement at all. Frank and open statements, bearing upon their face the evidence of a true condition of affairs, are, to my mind, the greatest factors in establishing credit. Nothing will more firmly cement the union between borrower and banker than such a statement, and nothing will be of more value to a banker and of less harm to an honest, enterprising borrower. Hidden facts are revealed by analysis and skill in reading between the lines is an important part of the credit man's training. By this means, weaknesses may frequently be discovered and proper steps taken to avert trouble before acute difficulty arises.

Let us summarize, then, the principles and rules of the credit science of to-day.

Its principles:

1. To reduce losses.
2. To eliminate disproportionate risks.
3. To conserve worthy interests.
4. To war on dishonesty and incompetence.

Its Mechanism:

1. The statement of condition, including—
   Assets and liabilities.
   Annual business
   Net result of business.
   Commercial expenses.
2. The credit department.

Its guiding rules in the present state of bank credits.

Rule No. 1. Quick assets only are a basis for loans.

Rule No. 2. Fixed assets, only considered as giving an unknown support to the quick assets.

Rule No. 3. The debt limit of the borrower has been exceeded when his liabilities exceed 50 per cent. of his quick assets (the so-called 50 per cent. credit rule).

Having made a careful review of the credit science of to-day, let us turn to a consideration of what shall be the next step in its development. At the outset we remarked that there was a growing requirement that bankers in large money centres should be expert in credit matters; it is necessary, therefore, that the means or mechanism by which we are to inform ourselves should be kept fully abreast of the times. Permit me to state my conclusion that the next step in the development of credit science will be in the direction of accuracy. The trend of every science is toward exactness. The advance to this point justifies a further step in advance. Lower rates of interest on loans make losses intolerable. General prosperity and other conditions with which we are familiar have limited the field for commercial loans at paying rates and require us carefully to safeguard any extension of the field of loans by exact and accurate credit tests.

How shall this next step be taken? By establishing the custom of requiring statements of financial condition to bear joint certificates of a certified public accountant and of an engineer:—

1. As to valuation of cash assets.
2. As to valuation of merchandise assets.
3. As to valuation of plant assets.
4. As to liabilities.
5. As to net worth.
6. As to gross business.
7. As to past results of business.
8. As to future prospects.

The certified public accountant has come into prominence within the last ten years and his profession has the guarantee of law in most states of the Union. He concerns himself with the books of account, and records and statements prepared by him have the support of such books, and the banker has the sense of security due to the disinterested and impartial nature of the accountant's position. He may be called the referee in accountancy and the expert on cash valuations.

The engineer deals with physical matters. His valuation on merchandise is essential in determining quick assets. He concerns himself with the valuation of the fixed assets and the adaptibility of the plant to the purposes for which it is being used. His analysis

of all correlated questions respecting raw supplies, vulnerability to competition, price fluctuations, trade, and similar conditions is essential to a right interpretation of statements of concerns affected by such questions.

But why is this radical step made necessary? Because inaccurate and dishonest statements are being constantly received. Many statements reach us which are made by irresponsible parties—clerks and under-men—and the management is frequently in ignorance of true conditions. Protection against such is essential.

The radicalness of the step is only apparent, not real—as all will be benefited by the examination proposed. The interpretation of credit statements is a technical operation, and the statements prepared by trustworthy professional men are generally more reliable than those not so prepared. The hard and fast 50 per cent. credit rule will soon fail, and an exact and accurate study of each individual concern will take its place, each concern being entitled to credit on its merits. Working on imperfect information and applying one credit rule has resulted necessarily in a destructive policy. Accuracy will enable us to follow a constructive policy, which I believe is more nearly in accord with our position in the business world.

In brief, our next step is in the direction of accuracy. This is to be accomplished by having statements subjected to searching analysis certified to by certified public accountants and engineers, and then credit will be extended strictly on the merit of the individual applying for loans.

We are a practical people who are more given to consideration of improving our methods than to reflection upon our existing greatness, or that of our predecessors. For that reason I have up to this time devoted your attention to progress in methods and means of credit research. I will now turn your attention to some practical features of the business we are doing based on bank credits. I have been much interested in determining the relative volume of bank loans on commercial paper to the various classes of borrowers. While this relation undoubtedly fluctuates widely it is my conclusion that the following statement reflects about the average condition:

	Per cent.
Commercial loans by banks to manufacturers	50
Commercial loans by banks to commission men	15
Commercial loans by banks to jobbers	30
Commercial loans by banks to retailers	5
	100

This was ascertained from the distribution of 186 different loans, aggregating upwards of thirteen million dollars. The average distribution of some sixty million dollars of loans placed through brokers in New York gave the following relative proportions:

	Per cent.
Commercial loans through brokers to manufacturers	45
Commercial loans through brokers to commission men	15
Commercial loans through brokers to jobbers	30
Commercial loans through brokers to retailers	10
	100

The striking preponderance of loans from banks to manufacturers is evident from both of these statements. It becomes of interest to us, then, to study further these various classes of borrowers, and I have prepared from the statements of some one hundred concerns a set of typical balance sheets that will bring before us some credit features, which it will be of profit to us to study with care.

Typical balance sheet for manufacturers:

Number of concerns averaged		62
		Per cent.
Quick assets	$1,000,000	44
Fixed assets	1,270,000	56
Total assets	$2,270,000	100
Liabilities	610,000	27
Net worth	$1,660,000	73

Liabilities 61 per cent. of quick assets.

Gross sales per $1 quick assets $3.30
for 44 concerns.

Gross sales per $1 total assets $1.60
for 44 concerns.

Typical balance sheet for commission men:

Number of concerns averaged 7

		Per cent.
Quick assets	$1,000,000	95
Fixed assets	50,000	5
Total assets	$1,050,000	100
Liabilities	520,000	50
Net worth	$530,000	50

Liabilities 52 per cent. of quick assets.

Gross sales per $1 quick assets	$3.60
Gross sales per $1 total assets	3.45

Typical balance sheet for jobbers:

Number of concerns averaged		28
		Per cent.
Quick assets	$1,000,000	90
Fixed assets	110,000	10
Total assets	1,110,000	100
Liabilities	440,000	40
Net worth	$670,000	60

Liabilities 44 per cent of quick assets.

Gross sales per $1 quick assets on 25 concerns.	$2.25
Gross sales per $1 total assets on 25 concerns.	2.08

Typical balance sheet for retailers:

Number of concerns averaged		6
		Per cent.
Quick assets	$1,000,000	75
Fixed assets	330,000	25
Total assets	$1,330,000	100
Liabilities	480,000	36
Net worth	$850,000	64

Liabilities 48 per cent. of quick assets.

Gross sales per $1 quick assets on 5 concerns.	$2.33
Gross sales per $1 total assets on 5 concerns.	$1.82

The exactness of these relations is not important for our study of the principles involved in credit research. Suffice it to say that a

study of the several balance sheets will, I believe, disclose interesting comparisons. It is instructive to note in these balance sheets the relative proportion of quick to total assets:

	Per cent
Manufacturers have quick assets of total assets	44
Commission men have quick assets of total assets	95
Jobbers have quick assets of total assets	90
Retailers have quick assets of total assets	75

What stronger argument could we have for accuracy in our credit methods than that manufacturers, who borrow one-half the money loaned on commercial paper, have 56 per cent. of their assets in such form that we reject them as unknown and unknowable on account of our imperfect information and inability to determine their value?

Again, referring to these balance sheets, let us compare the net worth of these classes of borrowers:

Manufacturers	show net worth 73 per cent. of their assets.
Commission men	show net worth 50 per cent. of their assets.
Jobbers	show net worth 60 per cent. of their assets.
Retailers	show net worth 64 per cent. of their assets.

From the face of this statement the manufacturer maintains an eminently satisfactory margin behind his loans, and what we will want to know in the future is that this claimed margin is conservatively valued.

Let us now examine into the gross sales which tell the tale of the entire managerial activity, the mobility of the quick or working capital:

Manufacturers,	gross sales per $1 quick assets	$3.30
Commission men,	gross sales per $1 quick assets	3.60
Jobbers,	gross sales per $1 quick assets	2.25
Retailers,	gross sales per $1 quick assets	2.33

Here we are face to face with the most telling factor against a hard and fast credit test, in that the wide difference in results in the various lines of business are brought out. How can a uniform credit test be applied to such widely varying lines of business?

Of equal importance in showing the variations in different lines of commercial enterprise are the figures comparing the gross business done per $1 of total assets, representing as it does the total investment in plant and working capital:

Manufacturers,	gross	sales	per	$1	total assets	$1.60
Commission men,	gross	sales	per	$1	total assets	3.45
Jobbers,	gross	sales	per	$1	total assets	2.08
Retailers,	gross	sales	per	$1	total assets	1.82

Becoming more specific in our inquiry we may also come to the conclusion that if a uniform credit test fails, when applied to various lines of business, such as manufacturing, jobbing, etc., it will also fail when applied to various branches of the same line of business.

The following figures taken from the twelfth census of the United States will illustrate the wide variations among manufacturing interests. In 1900 the census report, covering the various branches of the manufacturing division of commercial affairs showed a proportion of working capital to total capital as follows:

	Number Concerns		Per Cent.	
Food products	61,302	Working cap.	46	Total cap.
Textiles	30,048	" "	54	" "
Iron and steel	13,896	" "	50	" "
Lumber	47,079	" "	45	" "
Leather	16,989	" "	72	" "
Paper and printing	26,747	" "	40	" "
Liquors	7,861	" "	41	" "
Chemicals	5,444	" "	51	" "
Clay, glass, etc.	14,809	" "	37	" "
Metals	16,305	" "	52	" "
Tobacco	15,252	" "	76	" "
Vehicles for land trans'n	10,113	" "	53	" "
Shipbuilding	1,116	" "	45	" "

There will be noted a fluctuation from 37 per cent. to 76 per cent. and the entire industry averaged 48.8 per cent., these variations emphasizing the futility of uniform credit tests.

The census report also gave some interesting facts regarding the fluctuations in the gross business per $1 working capital and $1 total capital as shown below:

	Number Concerns.	Gross Business Per $1 Working Cap.	Gross Business Per $1 Total Cap.
Food products	61,302	$5.22	$2.42
Textiles	30,048	2.24	1.20
Iron and steel	13,896	2.33	1.17
Lumber	47,079	2.40	1.09
Leather	16,989	2.35	1.71
Paper and printing	26,747	2.70	1.09

Liquors	7,861	1.96	.79
Chemicals	5,444	2.17	1.11
Clay, glass, etc.	14,809	2.28	.83
Metals	16,305	3.52	1.83
Tobacco	15,252	3.02	2.28
Vehicles for land trans'n.	10,113	2.42	1.21
Shipbuilding	1,116	2.14	.97
Average		$2.70	$1.32

Observing this, it will be noted that the gross business per $1 of working capital varied from $1.96 to $5.22. The gross business per $1 of total capital varied from 79 cents to $2.42. Does this not further emphasize the fact that lines of business should be judged strictly on their individual merits, rather than by hard and fast rules?

It would be interesting, if we had time, to compare many of the branches of these industries which vary even more widely than the grand division of manufacturers. Every consideration seems to impress the fact that one of the cardinal and fundamental principles of credit science must be accuracy in all the term implies. This forces us to the conclusion that the 50 per cent. credit rule as regards quick assets to liabilities will not long be the chief factor in fixing upon the responsibility of borrowers in the light of the wide variation among the various classes enumerated. The time is coming when we shall be compelled to secure information which is accurate and reliable, and which has behind it the weight of certification and proof.

As to the future: We are naturally looking forward to extending commercial loans at paying rates of interest. Inasmuch as loans which are secured by assets not readily convertible into cash, are those which are subject to higher rates, it seems probable that the field of the manufactures, now representing fully one-half of the loans direct from banks, is entitled to the most careful consideration in the study of bank credits, and is of such importance as to demand of us intelligent examination and scientific treatment.

The manufacturers of the United States, numbering upwards of 500,000 concerns, have a gross business of, probably, $13,000,000,000, requiring an investment in plant and working capital of $10,000,000,000, the working capital being something under $500,000,000—a volume of business and extent of investment which is stupendous in the extreme. The manufacturer is essentially the prime mover

of commerce, and has to carry a large investment in plant and machinery. Invention and improvement of machinery and products are continuous, thus making large inroads into his sinking fund for renewals and scrapped machinery. He must maintain large stocks of raw material and be secure in the continuity of his supplies. He must carry large values of goods in process. He must risk the fluctuations in the cost of raw materials and sales value of his finished goods. He must take chances on changes in style and be at the mercy of the caprice of fashion. All of these considerations should lead us to count upon the manufacturer as substantial, conservative, keen after business, acute for economies; and the extent of his investment should give him such an intense personal interest in his enterprise that we should expect to find him the most promising of our applicants for loans. But to handle this business safely and wisely demands accuracy in our credit methods.

In conclusion, permit me to say that credit science occupies a prominent place in commercial affairs. The requirement of credit is a proper and necessary condition of business, and the usefulness of credit is firmly established. Every consideration demands of us that as this science develops it shall be firmly established in all respects upon substantial principles, and that as its rules and customs are unfolded from time to time they shall serve to strengthen jointly the bank in extending credit and the borrower in taking advantage of the credit. It will require joint and harmonious action on the part of all interested in bank credits to successfully accomplish the forward step which has been outlined in these remarks, but if this is accomplished, judging from our experiences in the past, the results will be of surpassing value to the entire commercial community. Let us restate, then, the principal facts regarding this advanced step:

1. It shall be in the direction of accuracy.

2. Statements of condition shall be required of borrowers bearing the certificate of certified public accountants and of engineers.

3. Statements of condition shall be invariably analyzed faithfully and accurately, and with all the thoroughness, weight of experience, and knowledge which can be brought to bear upon them by our best organization and equipment.

BANK AUDITS

ADDRESS DELIVERED BY SEYMOUR WALTON, C. P. A., OF THE FIRM BUCHANAN, WALTON, TOPLIN AND DEVOR, OF CHICAGO, BEFORE THE WISCONSIN BANKERS' ASSOCIATION AT ASHLAND, JULY, 1905.

As strong as the force of gravitation in the physical universe is the force of habit in the moral and mental world. Men are constantly running into grooves or ruts in all their activities, whether social, religious, or business. This is specially true of their business lives and arises partly from insufficient time, partly from disinclination to exert themselves, and very often from lack of knowledge of anything more desirable. While these facts are true of persons engaged in any business, they are especially so in the banking profession. The work of one day is so like that of another that the tendency to fall into routine habits is almost irresistible, and there seems little or no opportunity for originality. Yet there are few places where originality is more needed and where a proper use of brains is more valuable than behind the counter of a bank. The great difficulty in most banks, especially in the large cities, is that the banker is so constantly occupied that he has no time to develop any ideas, if he has the foundation for them. He is too busy to study the details of the bank's business in such a way as to discover the evidences of irregularities even when they would seem to have been very apparent, judged in the light of after events; or to make the proper deductions in regard to the real condition of its customers, even if he knows that a careful scrutiny of their accounts will often reveal very interesting facts. For instance, he does not take the trouble to ascertain the relation between a customer's yearly sales and the amount of his bank movement during the same time. Yet there is no more valuable information in regard to a borrowing customer than the fact, if it exists, that his total deposits, excluding his single-name paper, are considerably in excess of his total sales. The excess is suspicious, to say the least, as it must consist of items that are of a kiting nature or otherwise illegitimate. It is far easier for the credit man of the bank to make a few preliminary investigations, accept the customer's own statement of his net worth, grant him a line of credit and then drop quietly and easily into a rut and stay there until he is rudely jostled out of it by a bankruptcy notice.

In the same way the officers of a bank acquire the habit of implicitly trusting their clerks and their fellow-officers. Each one of them, working in his own particular groove, soon becomes satisfied if his own department is correctly handled, and pays no attention to any one else, except when his groove happens to meet or cross that of another. As long as everything is properly adjusted to meet the requirements of his own particular balance, he pays little attention to how the adjustment is effected. In the nature of things he cannot be expected to concern himself with anything outside of his own department, and certainly is not called upon to investigate the intricacies of his neighbor's special province. But it is this very habit of confining each man to his own peculiar rut that offers the opportunity for the misapplication of funds, when temptations assail a man too weak to resist it. Some banks attempt to obviate this difficulty by a constant exchange of duties on the part of their working force. This plan unquestionably takes the men out of their grooves and is an absolute preventive of trouble, but it is open to the objection that customers do not like to deal with different persons when they have become accustomed to having their affairs satisfactorily looked after by those who know and respect their various peculiarities. Other institutions have a general clerk or auditor whose duty it is to check up each department, but the auditor himself is liable to get into a groove and to perform his duties in a perfunctory manner. He is also subject to limitations when the irregularity that he may detect is the work of an officer of the bank, whom he does not dare to criticise unless the fault has already amounted to criminality. The only other protection now employed by the majority of banks is afforded by the infrequent visits of the official examiner, whose time is too limited and whose examination is too superficial to detect any but the most glaring irregularities. As long as the banking law is obeyed as to the reserve, the 10 per cent. limitation on loans, and other specific legal demands are satisfactorily met, his duty is fulfilled. Any ordinary well-covered irregularity is sure to escape his attention and he should not be blamed if it does. It is the duty of the directors to see that the officers are properly discharging the functions of their respective positions and of the officers to supervise properly the work of the employees. It would be difficult to find a case in banking history where a defalcation would not

have been prevented if all the officers had been properly alert in their attention to facts whose significance became apparent after the discovery of the shortage, but which had been overlooked in the hurry of daily work or ignored because the surface routine had not been disturbed by the malign forces at work underneath.

It is hardly fair to blame very seriously the bank officers for their neglect to cover all the points at which an attack may be made on the defences of the bank against manipulation of the accounts. They have usually enough to do to protect themselves from assault by outside enemies, the danger from which is more apparent and also more frequent than that from traitors inside their own walls. Constant intercourse with their daily associates makes the idea of any treachery on their part almost an unthinkable proposition. The universal exclamation when the wrong is discovered is: "I would as soon have thought of suspecting myself." It is natural that this condition should exist, and it would be a very unfortunate thing if this mutual confidence and esteem were broken up and each man in a bank were to be an Ishmael with "his hand against every man, and every man's hand against him." Each would feel that his neighbor was a spy, and every little suspicious circumstance would be exaggerated into a crime. Yet between this impossible condition and the indifference which results from the inertia of the routine habit, there seems no middle course possible to those inside the walls of the bank.

We are, then, forced to the conclusion that, if any remedy is to be found, it must be looked for outside the bank itself. The present Comptroller of the Currency has already suggested this in his able address to the Illinois bankers last October, in which he said: "In addition to such exhibitions as are made at regular meetings, the directors should have frequent thorough examinations by committees of the board or experts employed for the purpose. These should be made independently of the active officers of the bank. Every clerk and every officer of the bank should be examined and checked up as thoroughly as possible, and required to show the examining committee or auditor just how the matters in his charge stand. No man who is in a position of trust has any right to resent such examination, and one who has a proper appreciation of the relation he bears to those who have reposed trust and confidence

in him will welcome such an opportunity to show that he has been faithful and efficient." With such high authority in favor of the outside auditor no argument should be needed to demonstrate his value.

A word may be said about the auditing committee of the board of directors. In connection with the value of the contents of the portfolio their advice is probably the best obtainable. They are in a position to know the financial condition of their borrowing customers, as well as it can be ascertained in any way, except by requiring periodical statements made by an outside trained accountant. But when it comes to the intricacies of the accounts, it is a rare thing to find on the board of any bank a director who is qualified by experience to understand them sufficiently to detect any but the most glaring irregularities. The ordinary board of directors is composed of busy men who have time to give only the most cursory attention to the affairs of the bank. The officers and clerks have grown up, perhaps, from boyhood under their eyes, and for many long years have faithfully executed the trust confided to them. It is no wonder that the directors learn to rely upon them implicitly, even to the extent of refusing to appoint an examining committee when requested to do so by some officer who desires to force them into taking their just share in the responsibility of the active management. With the directors deep in the rut of absolute confidence in the officers and the officers equally deep in their rut of perfect reliance on the clerks, it is easy for a designing man to find an opportunity to take advantage of the situation, knowing that he will be secure as long as he does not allow any of his operations to encroach on any one else's particular rut.

In such a condition of affairs, not by any means an uncommon condition, as every banker knows, there would seem to be no possibility of protecting the bank from the unlooked for traitor by any means now in common use. The profession which I represent asks you to consider the claim of the certified public accountant to be the best person to offer protection to the bank, as he has for years successfully given it to the merchant and manufacturer.

It is only within the last few years that the profession of the public accountant has been brought into prominence, and it is still not so well understood as it should be by those to whom his services

are of value. He is a man whose training is entirely along the lines of the scientific investigation of accounts, which is a very different thing from the mere certification of their mechanical accuracy. A number of the states have recognized the new profession by passing laws allowing the title of certified public accountants to be borne only by those who are able by long experience or by passing a severe examination to demonstrate their fitness for the work required of them. As their clients are found in all lines of business they are constantly brought in touch with an infinite variety of accounts and are, therefore, in little danger of falling into ruts or grooves; and being independent of any special influence they are not liable to favor even the higher officials if there is anything that needs criticism or reform. Their training teaches them to simplify accounts as far as possible, and at the same time to make all the departments of an office fit into each other so as to make a harmonious whole, each part so closely related to every other that an irregularity in one place will throw the machinery in another out of gear. They may be said to put interlocking switches at the points where one groove crosses another, which will to a certain extent automatically prevent trouble in either.

It is difficult to formulate a universal system applicable to all officers, even in the same line of business, and, while banking accounts are as simple as any, no one institution is so precisely like another that it would be safe to say that the same methods would exactly fit all cases. Each individual bank must be studied to ascertain just what its particular needs are, and how best to meet them. And where loose and slip-shod habits have been broken up, there must be constant vigilance to prevent their return or the adoption of equally dangerous new ones. The contention of the public accountants is that the most effective vigilance can be exercised by those who are fitted by their whole training to discover and remedy flaws in methods, and who approach the task of a periodic audit with minds free from prejudice or bias, and with sufficient time at their disposal to give the subject the attention it deserves.

The saying that each man thinks all men mortal but himself can be paralleled by the virtual certainty each banker has that his particular office contains none but men of the most sterling integrity. Each one thinks that auditing precautions are excellent for every

bank but his own, but is so sure of his own associates that he does not need anything of the kind himself. To the credit of human nature it may be said that he is usually right. The vast majority of men are honest. If it were not so, the record of financial delinquencies would be far longer than it is, for there is no question but that the opportunities for wrong-doing are almost limitless. The honest man, however, does not object to a proper supervision of his work, and should welcome it as a protection against the weakness of his own human nature. For nearly every case of shortage is accurately described by the phrase, "A good man gone wrong." It is very seldom a case of deliberate dishonesty. The man is usually a really good man in his intentions and his natural tendencies, but he is weak and unable to stand the temptation that comes in subtle guise when he thinks he sees an absolutely sure way to make considerable sums if he only had sufficient capital to start with. He is so sure of his calculations that he feels justified in temporarily using the funds of others, expecting to return them in a short time, after having caused them to earn a fortune of more or less magnitude for himself. It can never be known how many men have been successful in these calculations and have since returned to the straight and narrow path. We hear only of the failures, and not all of them, for a very considerable proportion are hushed up for fear of the disastrous effects on the credit of the bank.

As a means of justifying the confidence of the general public in the correct management of the bank it would be a great advantage to have it known that it has adopted the precaution of having a thorough examination made by an unprejudiced and competent accountant. If this certificate, worded in general terms, were exhibited in the public banking room, and with it there appeared another certificate signed by a committee of the directors, or better still by a committee of stockholders, not officially connected with the bank, that they had examined the discounted paper on hand and had considered it good, the confidence engendered by the willingness to submit to this test would probably far more than pay for the expense of the examination by the additional business it would bring to the bank. This plan would also have a good effect on the directors themselves, who might be prevented from making some questionable loan for fear it would not pass the scrutiny of the committee,

and would certainly have a deterrent effect on the conduct of those bank officials whose directors allow them to have full control of the management of the bank.

The professional accountants of the country commend the subject to the careful attention of the banks, confident that a proper study of the situation will develop plans that will render less frequent the distressing occurrences that have recently shocked the financial world.

SECURITIES THAT ARE NOT SECURITIES

ADDRESS DELIVERED BY J. T. BRADLEY, CASHIER, FIRST NATIONAL BANK, SEDAN, KANSAS, BEFORE THE KANSAS BANKERS' ASSOCIATION, 1905.

THIS subject suggests two general classes of security: First, that which *is* security and, second, that which is *not* security. By security is meant any kind of property, thing, right, privilege, franchise, service, person, corporate body, or municipality, pledged to the payment of an obligation, or debt, or to a performance. Any pledge made which causes the fulfillment of a thing to be done at the time and in the manner specified in an agreement or contract is security that secures. If it fails to cause the fulfillment of the obligation, agreement, or contract in the manner or at the time specified, or within a reasonable time thereafter, or at all, it is security that does not secure.

To be specific: Any note, bond, warrant, order, draft, or other evidence of indebtedness, which is secured by a person, corporation, or municipality, or by a pledge of property of any kind or character, which insures prompt payment or fulfillment, is security that secures; if it fails to secure payment or fulfillment promptly or within a reasonable time or at all, then it is not security.

It is not the principal note, bond, mortgage, order, warrant, or other evidence of indebtedness that is the thing of value, but that which stands behind—as the money to be paid, the service to be performed, the right or privilege to be granted, the property to be transferred, and it is to cause these performances that security is taken. It is a fact that security which secures at one time or under

certain conditions will not secure at other times and under different conditions. Growing crops are a good example of this. Stocks in corporations which under good management and under certain conditions would secure, under poor management or under unfavorable conditions would be no security at all. Security that is "gilt edge" when first taken may become worthless during the term for which pledged; and security which does not secure when taken may become good before the maturity of the obligation.

Security may be individual, or may consist of property pledged direct, or may consist of other securities. When security is individual, not only all the property of the signer, but honor as well is pledged; but the pledge is general and gives no preference to creditors. When there is a specific pledge of property as security, a legal agreement to that effect must be executed which holds the specific property pledged to the payment of the particular debt, obligation, or performance; in which case the property may be left in custody of pledger for the benefit of the pledgee; or other securities may be pledged, in which case possession, but not ownership, changes hands.

The selection of persons, property, and other securities that will secure and the rejection of such as will not secure the performance desired is the quality necessary to the money lender. It can be readily seen that an intimate knowledge of the present and future value of property and securities and a sound judgment of the character of men is essential. When one or more names are accepted to secure the payment of an obligation, it is necessary to know that the persons are honorable and have the disposition and ability to pay.

There is a moral as well as a physical element to be considered in the loaning of money, and generally the moral element is paramount. Different communities have to deal with different securities. In Kansas the usual kinds are land, city lots, and occasionally the appurtenances to real estate, apart from the real estate; growing crops, rough feed, grain, elevator and warehouse receipts, bills of lading, live stock, poultry, produce, stocks, bonds, notes, contracts, leases, orders, warrants, certificates of deposit, insurance, products of mines, implements, machinery, furniture, merchandise, libraries, jewelry, personal service, rents, and perhaps others. Much of the

property named is unfit for security, but all of it has been accepted. In deciding what security does not secure, certain well-known rules should be followed:

First—Security should be a definitely known quantity.

Second—It should be readily convertible into cash.

Third—It should be legally pledged.

Fourth—The pledger's title should be unquestionable.

Fifth—It should secure a specific debt.

Sixth—It should be so accurately described as not to be mistaken.

Seventh—It should have sufficient value to cover the indebtedness, probable expenses of collection, all contingent charges against it, and reasonable depreciation.

Eight—Security left in the possession of the pledger should be definitely located.

Ninth—The pledger's character for integrity, prudence, industry, and ability should be favorable.

Applying these rules to the various classes of property mentioned, we can eliminate that which is undesirable as security and which will probably not secure.

We discard all stocks of corporations whose capital consists of the prospective value of undeveloped property, or which has no present value, and that in unprofitable enterprises; growing crops, machinery in abandoned mills and failed enterprises, and that which is worn out or out of date, insurance polices having no cash surrender value, real estate having defective title and, generally, second mortgages, especially on personal property; bonds and stocks that have no market value, stocks of merchandise, unless the owner is free from debt or provision is made for payment and immediate possession is taken, household furniture needed for family use, past due notes, unless it is known there are no offsets; notes running a much longer time than the principal debt, all impractical machinery, grain and feed for the sustenance of live stock, unless included with the stock; libraries, perishable products, part of a herd of live stock of the same description, unless specifically marked or separated from the herd; grain elevators, unless well located and at a low valuation; one animal, leases providing for a share of production as the rental; usually security which may be good, but which is remote and not known to the pledgee; persons in bad repute, known to be tricky and

dishonest in business; persons engaged in business they know nothing about, where all their means are invested in the business, and persons without means, wishing to borrow for investment. Contracts are doubtful quantities and should rarely be accepted as security, excepting in case of contracts for sale of property taken for debts, where the property remains in possession of the seller.

It is not intended to advise the rejection of all items on the foregoing list as security under all circumstances, but in making original loans it is strongly recommended. It sometimes becomes necessary in renewals to take the best that can be had, and in such cases it is prudent to take anything, present or prospective, that holds out a promise. Eternal vigilance should be practiced at all times to see that the mortgage or collateral contract does not lapse. Many a well secured loan has been lost by negligence of this kind, and when, too late, discovery has been made that the security did not secure. An endorser for value should not be accepted without a waiver of protest. If protest is not made on day of maturity, unless it is waived or other notice of non-payment is given, the endorser is released. In case of an endorser as surety, never make a renewal without his written consent, and to avoid all mistakes of this kind, take a new note. It is necessary to have all parties join in a new contract, else the ones who do not are released on the original.

A case like the following one was once tried in the district court of Chautauqua County, Kansas: A took a note from B, with C as surety. A bought D's cattle and offered the note in part payment. D agreed to accept it if A would get another signed by D; which was done. A then endorsed and delivered the note to D. Before maturity A bought it back and after maturity sued B and C in default of payment, but did not make the additional endorsement obtained at D's request a party. The court refused judgment on the note on the ground that it was not the same instrument he accepted from B, having been changed by the additional name without the knowledge or consent of B and C. This is a case where security did not secure.

The most fruitful source of bad paper is the practice of overloaning and permitting numerous renewals. Both have a tendency, in the process of evolution, toward an exhaustion of security before the debt is paid. The fact is that some men have the capacity for

large things, and some have not. If a person who has not, but thinks he has, can find a banker who does not know whether he has or not, but is willing to chance it, the foundation is laid for a good-sized loss. This is a good time to suggest the question: Are bankers justified in making excess loans or numerously repeated renewals? The latter is equivalent to making an investment in the borrower's business, instead of lending him money. Ultimately the practice is detrimental to both bank and customer.

REQUISITES OF A GOOD LOAN

ADDRESS DELIVERED BY E. T. COMAN, CASHIER OF THE FIRST NATIONAL BANK, COLFAX, WASHINGTON, BEFORE THE WASHINGTON BANKERS' ASSOCIATION AT WALLA WALLA, JUNE, 1904.

THE question, "What constitutes a good loan?" is one that comes to every banker many times each day. Upon its correct answer, made on the spur of the moment, lies the secret of success or failure of the bank entrusted to the care of the person to whom this question is put. This responsibility is one that cannot be shifted easily to another, as the knowledge of men and conditions essential to the correct answer is acquired by years of study of business and of individuals. To the man who can invariably give the correct answer to the application for accommodation, there is open a place behind the executive desk of the largest financial institutions of the world. It is as important to have said "yes" when the applicant was entitled to credit as it is to have said "no" when the granting of credit involved the probability of a loss. The banker exercises no arbitrary discretion when he extends or refuses accommodation to the borrower. Within certain, perhaps not too well defined lines, he is the servant of the public, rather than the autocrat, which is sometimes popularly supposed to represent the ideal of a banker. In no department of its utilities is the business of a bank to be increased so surely or so fast as in the judicious granting of credit to those justly entitled thereto. While it is popularly called "accommodation" when a banker extends credit to an applicant, yet the accommodation is mutual if the conditions are right. For

a banker to refuse a loan to a customer who is entitled to it by reason of his responsibility and his account in the bank, is to fail to fulfill his function as a part of the commercial life of his community and to make public acknowledgment that there is weakness somewhere in the management of his institution. To be subject to such an arraignment, it must be an unqualifiedly good loan that is turned down.

If each banker here were to be asked the question, "What constitutes a good loan?" it is likely that there would be almost as many different answers as there are members assembled, each differing according to environment and experience. Says one, "A good loan is one secured on United States bonds as collateral with a reasonable margin for shrinkage." That would indisputably be a good loan; but unfortunately not all of the collateral that is presented to the cashier's window consists of government bonds alone, but is apt to be what Wall Street denominates mixed collateral.

Among the bankers of Iowa, Missouri, Kansas, and Nebraska no paper is considered so choice as that offered by the cattle feeder. These bankers do not hesitate to advance the entire purchase price of a bunch of steers, provided the applicant for the loan has the corn with which to make them beef; the prudent practice being to take a blanket mortgage on both corn and cattle. The competition to secure such paper has reduced the rate of interest to the lowest profitable basis, and brokerage firms have been established for the sole purpose of floating this class of paper. The dangers of overcompetition in luring bankers away from cautious, conservative methods were never better illustrated, nor was the punishment ever more prompt and severe than in the experience of the bankers in the central states with Gillette. This enterprising financier floated over a million dollars on an evanescent band of cattle and absconded, leaving a score or more of banks scattered from Chicago to Denver to mourn his departure and their loss. Such instances as this, which may be found of frequent occurrence, should put the banker on his guard in buying paper of even a well-rated individual or corporation, for there can be no absolute assurance that such may not be up to the limit with several institutions. It would be well if some scheme of closer co-operation could be devised that would protect the interests of bankers in handling commercial paper that

is offered on the open market, especially as of late there has developed such an extensive business in this line of investments. The fact that responsible firms, engaged in legitimate business, finance in part their enterprises by this means gives commercial paper its standing and makes it an attractive field for dishonest and irresponsible concerns to float loans based on inflated and fictitious assets. The only protection now offered to the country banker who seeks an outlet for his surplus funds in the purchase of commercial paper, is the advice of his city correspondent, or the recommendation of some brother banker operating in the place from which the paper emanates.

Human nature is much the same the world over. The country banker does not send his best customer paper on the markets of the world as long as he can possibly carry him from his own resources. The answers given to inquiries of this sort are seldom satisfactory and not always disinterested. A banker is not often free to disclose his information. He should be the recipient of the entire confidence of his customers, and he would be recreant to his trust indeed should he ever presume to reveal any of such secrets unless previously fully authorized so to do. The only other general source of information that exists, aside from the direct representations of the firms, is the reports of commercial agencies. There should be a more intimate relation than exists at present between the banking fraternity, who are the largest dealers in commercial credits, and the commercial agencies, whose business it is to establish correct credit ratings. Commercial agencies usually depend for their reports on their attorneys. Abraham Lincoln was once called upon to give a report on the financial standing of a brother attorney. Lincoln replied: "I called on Jones at his office and found that he had a wife and baby, and that ought to be worth $50,000 to any man; he possessed half a dozen law books, two wooden chairs, a pine table, and a rat hole that is certainly well worth looking into."

Lincoln's report is about as satisfactory as the average reply one gets from a letter of inquiry. The relations of the banker and the commercial agency are worthy of a paper devoted entirely to their elucidation. Suffice it to say there are grave risks involved in purchasing paper from brokers. The failure of the National Wheel Company some ten years ago left eighty-seven banks scattered

through the East holding such quantities of its bills payable that they were compelled to appoint representatives to assist in the reorganization of the concern and participate in its management for several years before the claims were finally liquidated. The failure of Porter Brothers and the subsequent publication of their condition revealed the fact that they had impartially distributed their evidences of indebtedness so that some even found lodgment in the tills of the bankers of the state of Washington. Yet such seemed the best of investments, for both of these concerns, cited for illustration, were rated with ample capital and high credit.

The purchase of commercial paper, however, represents but a temporary investment of funds, when there is a plethora. A bank is not fulfilling its full duty to its local community that thus uses its funds until after every legitimate local demand has been fully provided for. An authority on banking has asserted that a bank should have 20 per cent. of its investments in high grade bonds and securities such as are convertible at a moment's notice as may be required; 20 per cent. in commercial paper, which is purchased in the open market and which involves no obligation to renew at maturity, and the other 60 per cent. in loans to his customers at home in the current business. It is to this 60 per cent. of his investments that I would confine myself in endeavoring to give a definition of a good loan. It is also the viewpoint of one engaged in commercial banking, rather than that of the savings bank or trust company. The first seeks long time investments bearing low rates of interest with the first requisite, absolute security. The second, if we may judge from the records of some of the more recently organized trust companies and from the emphasis laid upon the interest paying advantages to depositors, seems to be a method of obtaining large loans from the general public, without security, for the purpose of financing the undertakings of its promoters.

With such limitations as above outlined a good loan may be defined as "Such an advance of credit as is a reasonable per cent. of the market value of commodities in the process of conversion into money." No definition or standard can be so precise or exact as to eliminate the necessity of the exercise of judgment in its application, and in no field of endeavor is there greater need for such exercise as in that of banking. Such a definition is like the preach-

er's text, but a basis from which to make an argument. A loan which conforms to the requirements outlined is worthy of a place in the most exclusive bill pouch. It is not intended to exclude that large line of loans based on undoubted collateral, but is intended to refer to that more important class which is connected with promoting the business interest of the community. It refers to the advances to the cattleman based on the herd which he expects to convert into beef; to the farmer, who desires to pay his current expenses for seeding and harvesting to be repaid with the marketing of his wheat, his cotton, or his corn. It includes loans to the manufacturer, who must stock up with raw material to be converted into the finished product in the regular course of business. It includes loans to the merchant, who has a stock of goods purchased in advance of his needs, and who prudently discounts his bills to repay his banker from current sales. It applies to the lumberman, who desires to employ temporarily large additions to his capital, to prepare his logs in the winter to be converted into lumber during the rest of the year, from the proceeds of which he will retire his obligations. It applies to the miller, who must fill his bins and warehouse when wheat is offered, to be converted into flour from day to day. It applies to the wheat buyer, who is on a large scale marketing the products of the farmer in the consuming centers of the world. In fact, it applies to any and all of the great industries whereby value is to be added to raw material by the application of labor to change its form or its situs.

Whether the commodity upon which the loan is made shall be reduced to actual or constructive possession depends on a number of considerations, the most important of which are the personal character and integrity of the borrower and his ability to handle the capital entrusted, temporarily, to his care. Doubts should be resolved in favor of the security, for in each instance it is the money of others that is in jeopardy, if danger there be. Security in possession is not practicable in many cases. The merchant or manufacturer has his capital in his goods and materials, which are not available for security except under chattel mortgage, and that would defeat one of the main objects of his discounting his bills, that of maintaining a high credit rating. If the borrower is possessed of integrity and honor, and his loan conforms to the definition, he will hold in sacred

trust, without legal formalities, that property for which the banker's money has been borrowed to enhance in value or prepare for market. It is in this connection that the banker must use the discriminating judgment which no text-book on banking can supply, and which comes from familiarity with local business conditions and intimate acquaintance with the personal habits, character, and ability of his customers. The application of this rule would exclude all loans which have the character of a permanent investment in the business of the borrower. Such is one of the dangers which constantly beset the counting house, and one which must be guarded against most vigilantly by the banker who would keep his assets convertible to meet the demands that may be made upon him. The time of maturity of paper may not be specified as thirty, sixty, or ninety days, but if not at a definite time it should mature upon the definite happening of an event which is of reasonable certainty of occurrence. Such, for example, is the maturity of a crop, the completion of a contract, the marketable condition of a herd of cattle, the shearing of a flock of sheep, the conversion into lumber of a drive of logs. It is these indeterminate loans that bring disaster to more banks than any other one cause external to the bank. The banker who receives money from his depositors repayable on demand or at short notice must be prepared at all times to meet a reasonable per cent. of his obligations. On the other hand, he owes a duty to his community as a banker to provide for all of the legitimate commercial demands for accommodation. To meet these apparently antagonistic demands, calls forth the exercise of that judgment which is the characteristic of the successful banker. Some bankers operate on the theory that they will loan to the extreme limit allowed by law, and keep their bills receivable at all times well up to or beyond their deposits. They operate on the theory that they will make all the profit possible, and if hard times come they will rely on their city correspondent to rediscount their paper to enable them to meet the demands of a decreasing deposit account. Is the game worth the candle? May not the lot of such a banker be comparable to that of the foolish virgins? When he applies to his reserve agent to carry him through the financial storm which finds him unprepared, the reply will be, "I know you not." A bank so conducted is taking too great a risk and throwing too much of the burden on a brother

bank. Each should be a support to the financial affairs of the country rather than a drag that must be provided for lest its fall endanger the whole financial fabric. The first resource of a banker when his cash reserves begin to run low should be his bonds and other securities, while his customers should be disturbed as little as possible in their legitimate undertakings; yet the bill pouch should be the banker's mainstay in meeting his obligations rather than that he be put in the humiliating position of relying on another banker more prudent than himself. Some bankers argue, with a semblance of logic, that it is better to earn $50,000 profit and suffer $10,000 loss each year than to earn half the profit and suffer no loss. Such a line of argument is fallacious, and its practice is suited to fair-weather banking only. When the stress of storm comes and the crash of financial houses causes him to examine more closely his resources, the liberal banker will be apt to find that about the same per cent. of his paper is bad as is represented by the proportion of annual loss to profits. In such a bank unsecured, indefinite overdrafts will abound, and the most active account is likely to be the overs and shorts.

The requisite of a good loan having once been determined, the next question is to whom shall these loans be made? Each loan should be made with a view of increasing the business of the bank. The loans should be to people who operate in the community in which the bank is doing business. In that way a large per cent. of the money finds its way back into the tills and is ready to do service again, while loans to persons operating at points remote from the location of the bank withdraw the funds from local circulation and they can perform their duty but once. Political, religious, social, and fraternal associations should have no weight whatever in determining the advisability of making a loan. Fortunate, indeed, is that banker who by genial disposition can attach many friends to himself and his institution, but it is unfortunate if such desirable traits of character render him amenable to the influence of the solicitation of friends, to the dethronement of cold, critical business judgment in passing upon all matters submitted to consideration in connection with his daily transactions. The banker is to the highest degree a trustee—a trustee, first, for his depositors, who expect from him that inflexible and undeviating integrity which can always be relied upon

under any and all circumstances; a trustee for his stockholders, who have entrusted him with the management of the enterprise they have launched with such hope of success and profit. In all of his dealings with the public this sense of trusteeship should be borne in mind, and the knowledge that in the execution of his sacred trust he should be held with even more strictness in his conscience and honor than ever the court of equity would exact in holding him to accountability for his actions.

While those to whom loans should be made might include all who are engaged in legitimate enterprises in the community or who have undoubted security to offer; yet there are those to whom loans should not be made, and chief among these is the banker himself. The strenuous business life of to-day demands of each individual who would win success the application of all his faculties and all his energies to the fullest extent. The banker is usually a well-paid employee, and in return for his liberal compensation he should render to his institution the best there is in him. If interested in various speculations, in the promotion of enterprises requiring financial assistance, he is not in the position of one who can exercise that impartial decision so essential to the best result in credit rating. No man can judge himself justly. If the private enterprises of the banker require assistance, it would be far better that he apply to the counter of some other banker, who can refuse to extend credit based solely on the merit of the application. It would be better still if the banker would confine his investments to lands, bonds, or mortgages, which can be looked after with but little distraction from the business of the bank.

There is no more honorable career than that of a banker who worthily fulfills his duties. He stands high in his community, is respected for his integrity, and is trusted and esteemed by his fellowman. Not even the cloth holds a higher place. While there may be some persons who doubt the promise given to those who will "lay up their treasures where the moth doth not corrupt and where thieves do not break through and steal," yet few there be who deny the desirability of a good bank balance, even though they may not have the ability or faculty of acquiring one. Such being the high position of the banker, he should not jeopardize it by the misuse of his position to his own personal advantage. Comptrollers of the currency

in their various reports to Congress have recommended legislation tending to prevent or restrict officers and directors of national banks from borrowing from the institutions under their charge. In the LVIth Congress Representative Brosius introduced a bill to correct this abuse, but it failed of passage. The necessity for some stringent legislation on this point is fully demonstrated by Comptroller Ridgely's last report. In this report are listed the records of 418 national banks which have failed since the inauguration of the system. The causes of failure, the amounts involved and the per cent. of loss, if any, are fully set forth in a series of valuable and instructive tables. The causes of failure are divided into twenty-six classes from A to Z, and from the great similarity between some of the classes, we may reduce the groups to eight, as follows:

F.	Excessive loans to others, injudicious banking, and depreciation of securities	26
J.	Excessive loans to others, and investments in real estate mortgages	6
K.	Excessive loans and failures of large debtors	25
U.	Injudicious banking	21
V.	Injudicious banking and depreciation of securities	63
X.	Investments in real estate and mortgages and depreciation of securities	14
Y.	General stringency in money markets, shrinkage in values, and imprudent methods of banking	49
	Total	204

The cause of failure of the remaining 214 banks covered by this report involves the management of the banks by reason of excessive loans to officers and directors, fraudulent management, and, in some cases, actual embezzlement. This is such a serious state of affairs that it justifies the comptroller in his repeated warnings to Congress and in his urging for remedial legislation. His efforts should be seconded by the bankers themselves, acting through their national and state associations. There is, however, a distinction to be made between loans to a cashier or other executive officer of a bank, and loans to a director. The former should be absolutely prohibited, while the evil that has ensued from excessive loans to directors may be easily corrected by surrounding them with sufficient safeguards. To deprive directors of loans would work to the injury of the banks, because every bank seeks to get upon its board of directors the

responsible, substantial business men of its community. It is a decided advantage to have men as directors who are engaged in active business, as they are more familiar with commercial conditions and needs. They are in position where their knowledge comes first hand, their judgment is based on their own information, and their advice is most valuable.

Loans to subordinates in a bank are undesirable. It is far better to have an inflexible rule which can be invoked to check such a request at the outset, than to have a refusal cause a diminution of that enthusiasm which characterizes the average bank employee toward his institution. Among no class of men is there such an admirable *esprit de corps* as among bank clerks. In no other class do you find organization the prime object of which is to make its members more efficient and more valuable to their employers.

The financial troubles that beset our country with each recurring season are not due to too little currency, but to the injudicious use of that we have. The per capita circulation of the United States is greater than that of any of the great commercial nations save France. The circulation increased from $2,260,000,000, or $28.66 per capita in 1902, to $2,532,000,000, or $31.02 per capita, in 1904. The commercial reports, the daily press, the expressions of the leading bankers in the East who are in close touch with conditions, assure us that in 1902 we passed the crest of prosperity. While business since has been good and conditions are healthy, yet trade is more conservative and the speculators are restricting their operations. The clearing house returns confirm the statement with a shrinkage of $9,000,000 from the highest point. In conformity with these conditions we would naturally expect that with a lessening of business operations there would be a decrease in the loan account of our banks, but in this the statistics do not bear us out. The loans and discounts of the national banks on—

February 25, 1901, were	$2,982,489,300.89
February 6, 1903	3,159,534,591.89
March 28, 1904	3,254,470,858.74

During the same period the mints of the country have been pouring a golden stream of coinage at a rate heretofore unprecedented in this or any other country for a similar period.

The organization of new national banks has increased the bank

note circulation $80,000,000. With diminishing trade activities and increasing currency there should be a reduction of the bills receivable account of the bank to correspond, if the loans of the banks were of that liquid character that is deemed requisite. If the loans conformed to our rule, they would automatically be reduced with lessened trade requirements. That the loans of many banks do not conform to this rule is patent to any one who will examine comparative statements and find a bills receivable account that fluctuates in the upward direction only. The zeal for large dividends and big business spurs the banker on to take desperate risks and to tie up his funds in investments that, while they may promise profit, are slow to realize upon, and the B-P account is irreducible to conform to business conditions. Liberal dividends are desirable and much appreciated by stockholders, but the smile of welcome which greeted the receipt of the liberal dividend check will have passed from memory long before the banker recovers from the frigid stare which greets the request to refund some of these profits to make good losses incurred through undue risks.

If loans were made which depended upon the sale of specific commodities for their repayment, the time of settlement would not be indefinitely postponed and the necessity for an emergency circulation would not press so earnestly upon us with each recurring crop season. It is not emergency circulation or increased circulation we need so much as greater flexibility in the loan account.

Some wag said of the original greenbacks, "They were like the Hebrew children, they were the issue of Abraham and knew not their redeemer." Of some notes it may be said they at least know not the time of their redemption. Let the current loans be made to conform to legitimate needs; exclude the right of a banker to manipulate his trust funds to his private advantage, and the chief cause of failure will have been remedied and banks will come nearer fulfilling all of the demands that may be made upon them.

"As good as the bank" has become a truism and a standard with which to measure the highest responsibility and integrity. It should be the ambition of every banker that this should not be a meaningless phrase. To have safely and honestly conducted the affairs of a banking institution, to have worthily received the trust and confidence of one's fellow-men, is to have achieved success, and better than

much gold is it to have left a heritage of an honored name and a record of a faithful execution of the highest trust. When the final summons comes to the good banker, he can wrap the drapery of his couch about him and lie him down to pleasant dreams, confident of an awakening into the fulness of his reward.

PAYMENT OF INTEREST BY DISCOUNT BANKS UPON COMMERCIAL DEPOSITS

ADDRESS DELIVERED BY FREDERICK D. KILBURN, EX-SUPERINTENDENT OF THE NEW YORK STATE BANKING DEPARTMENT, BEFORE THE STATE BANK SUPERVISORS' ASSOCIATION, 1905.

It has been suggested that I speak to this convention upon the subject of the payment of interest by discount banks upon commercial deposits. I wish to enlarge my subject by including that of the policy which ought to be pursued with reference to the payment of dividends.

It is obvious, of course, to every experienced banker that that policy in the general conduct of banking business is imperative which will tend to conserve the interests of the institution as a corporation or entity by itself, and which will above all other things insure the safety of depositors. Whatever tends to defeat this general result is contrary to sound banking principles, and will sooner or later lead to trouble, and possibly to failure.

It will, of course, be admitted that one who subscribes to the stock of a bank does so for the purpose of making money upon his investment. This object will be defeated if the policy which I have suggested is even partially ignored. The success of a bank depends more upon intelligent public confidence than upon anything else, for without this, deposits cannot be obtained, and without deposits, money cannot be made. This confidence among intelligent people will be based upon the character and probity of the directors and their management of the institution. If either of these elements is such as to repel public confidence, the institution is doomed sooner or later to failure. This confidence can be inspired only by men of char-

acter, and by good, safe, and conservative management. If conservatism is sacrificed to an undue anxiety for larger profits, disaster cannot be far distant.

I have spoken of and written upon the subjects of interest and dividends so frequently that it will be hard for me to do more than substantially repeat the arguments which I have advanced during the last nine years, the time I have been superintendent of banks.

I regard the payment of interest on commercial deposits by discount banks as the greatest menace in banking to-day. This custom has become so general, and the rate paid is on the average so great, that it constitutes the largest item of expense with which a bank has to deal. I do not believe that there is a conservative banker in the country to-day who does not down in his heart deprecate the practice of paying interest on these deposits, and who would not do away with it if he could see his way clear to do so without largely reducing the volume of his business. It is contrary to sound principles of banking, and, while it may in some localities, under peculiar local conditions, not be of that serious character which makes it very objectionable, the influence and example are bad, and unless carefully watched, will grow into proportions which will eventually make it an unsafe practice even in places where to-day it seems to work advantageously.

It is too often the fact that there are men in the banking business whose vision is so contracted as not to extend beyond the narrow limits of their own institutions, and who do not take into consideration anything but the immediate influence or effect which this policy may have upon the institutions with which they are directly connected. There are too many who think that the securing of an extra few thousand dollars on deposit is the one thing to be accomplished. They regard the swelling of deposits, by whatever means, as the one evidence of success which will attract the public. The fact that a course of this kind, if persisted in, may in the long run have a blighting effect upon the banking interests of the state generally seems entirely to escape their notice or consideration. They lose sight of the broad question and its effect outside of their immediate locality, and do not seem to realize that a substantial abolition of the practice throughout the state would make conditions so much better, and banks so much stronger, that their own institutions

would not only be benefited as a part of the general result, but that each bank would experience an immediate and direct benefit through its individual action in doing away with the practice.

This practice of paying interest on commercial deposits has in the last few years grown to such proportions that in many sections of every state it is relied upon as the chief means of attracting deposits. This competition has in many instances, and in many localities, developed into an unseemly scramble, and is often accompanied by undignified, misleading, and in some cases absolutely false advertising. I have many times remarked that the province of a bank, and the underlying idea and intention of its organization, is not to pay interest, but to get interest, to serve the public conservatively, and safely invest the funds committed to its care. Any bank that departs form this general policy enters the field of unsafe practices and speculative adventure.

I would not entirely condemn the payment of interest by banks. My contention is against the payment of interest on commercial deposits—the money used by merchants, tradesmen, and manufacturers in the daily transaction of business. To advocate anything more than this not only would make the task of any supervising officer in accomplishing any reform impossible, but would transform the faint hope of success which may be entertained by the advocacy of the abolition of the payment of interest upon the kind of deposits to which I refer into the certainty of absolute failure.

There are in most states, and especially in the great commercial states of the Union, other institutions organized for the express purpose of gathering and investing the money upon which interest should be paid. In my own state, as in many others, we have savings banks, which are the particular custodians of the money of those whom I have frequently termed the "provident poor." We also have trust companies, with which trust funds and other moneys not used in the daily transactions of commerce may be deposited upon interest. Savings banks are of an eleemosynary character, and best fitted for the care of the moneys which may be properly termed "savings." A bank of discount should not take this kind of money, but leave it to the care and custody of institutions organized for that purpose.

It is entirely proper that trust funds should be deposited in trust

companies, and that a rate of interest based upon existing conditions should be paid upon these deposits. These are not the kind of deposits of which I am speaking. What I decry, and the practice which I condemn, is the payment of interest upon money which is daily employed in the business of the country, and which is therefore necessarily subject to immediate call and frequent and violent fluctuations.

The task of accomplishing any reform in the direction I suggest, as I have already remarked, is a difficult one, and I am fully cognizant of the fact that individual effort will probably result in little or no good. It can be done only through impressing the bankers of the country with the seriousness of the practice, and the advisability of its abolition, or at least its material modification, and with the benefits which would surely follow if this course were taken.

Interest is a continuing and constant charge. It works day and night. It constantly adds to the obligations of a bank, and all banks which to any appreciable extent indulge in its payment must necessarily make corresponding gains and profits in order to meet this everlasting charge. This undermines conservatism. It leads officers and directors into investments which, were it not necessary to meet the interest charge, would not be made. In order to meet this charge there is a great anxiety to loan, and not only this, but to loan at the highest rates obtainable. It is a universal principle in banking that the loans which draw the highest rate of interest are as a rule the least desirable and the least safe. But the loans must be obtained. Good, conservative, gilt-edged loans will not answer the purpose; they will not yield revenue sufficient to meet the exorbitant interest rates paid by the bank upon deposits in addition to the legitimate expenses of the institution. Risks are taken which would not otherwise be done, and the whole conservative, sound, and safe administration of the affairs of a bank is gradually undermined, and, before the officers and directors are aware of the fact, the condition of the bank has perhaps become precarious—and all on account of this unwise practice of paying interest upon daily balances, or upon deposits of the character to which I have referred. The depositor himself loses sight of his own interest when he insists upon receiving interest upon the money which he is daily using in the transaction of his business. He loses sight of the fact that, if

the bank indulges generally in this practice, it is more than apt eventually to become unsafe, and to result in loss to himself and his fellow-depositors.

A bank which does not pay interest upon such deposits may loan money at a cheaper rate, the business of the bank will be more conservatively conducted, deposits will be safe, and business and borrowers will be benefited, and the bank in the long run will be ahead. The interests of both stockholders and depositors therefore demand, if not the entire abolition of interest upon commercial deposits, at least a very material reduction in its rate.

The public is most vitally interested in this question, and in the absolute soundness of the institutions with which it does business; for the effect of a bank failure is not confined to the immediate stockholder or depositor, but is reflected upon the entire community in which the bank is located. My observation leads me to believe that there are more banking failures directly traceable to exorbitant rates of interest paid upon deposits than to any other one cause.

In my own state we have communities where the banks pay as high as 4 per cent. upon a large proportion of their deposits. I have again and again called the attention of the bankers of my state to this practice, and have again and again warned them against its continuance. There is no law preventing it, and perhaps no law can be enacted which will prevent it, and a supervising officer can act only when he can demonstrate that the practice has grown to such an extent that it is unsafe and inexpedient for the institution to continue longer in business; and this simply means that it has been carried to such an extent that it has substantially ruined the institution.

I have succeeded in accomplishing some little reform in some places. In the city of Albany, for instance, not long since the bankers came to an agreement that they would not pay interest upon sums less than $10,000, payable on demand. Everybody in the city is satisfied. The bankers themselves are more than pleased with the result which has thus far obtained. I have succeeded in other places in having the rate reduced; but until the bankers themselves realize the unconservative nature of the practice, and the danger to which it will, in my opinion, ultimately lead, there is but little hope of any general reform. My efforts in this direction have been misinter-

preted by some, for I have received letters from depositors charging me with effort, and conspiracy, to benefit the banks at the expense of the depositors. They do not realize that this is a question which goes directly to the safety and stability of the institution, and therefore to the safety of their deposits. If the practice were universally abolished, none would be hurt, and many would be saved, for bidding for deposits would cease, and beneficial results would be reflected throughout the whole state and country.

Closely allied to the question of the payment of interest on commercial deposits is the policy of the payment of dividends to stockholders. What is the proper policy to pursue in this direction? As I have already in substance stated, the stability and absolute soundness of a bank as an entity are to be considered above all other questions. The mere suggestion that a solvent bank should not pay dividends will perhaps strike some as exceedingly novel, and as being tinctured with ultra-conservatism. I hope, however, if you will indulge me, to convince you—or, if not convince, to give you sufficient reasons, in my opinion, why you should be convinced—that a solvent bank under certain conditions may not wisely divide its earnings among its stockholders.

All business, aside from banking, in this country, where substantially all business is done through banks, is dependent upon the conservative care and correct principles with which the banking interests of the country are conducted. There is less room in banking than in any other business for experiment, or the employment of that kind of genius which is forever seeking new methods of money-making, and constantly discovering some shorter and quicker route to wealth than may be found in the old and sure methods which always characterize a solid and successful bank. Conservatism should be the great underlying principle governing banking institutions. This principle may not properly be applied to all things in life. There should be no conservatism in war, nor in love of country. A man should not conservatively love his wife and children, nor be conservatively unselfish. But in banking a man should never forget that he is the trusted custodian of the people's money, and that he has no more right to speculate or experiment with it, or take any unnecessary risk with it, however small that risk may be, than he has to see how near he can shoot to another and not hit him.

Occasionally dishonesty in bankers is discovered. This is an evil of banking that cannot well be guarded against, and which cannot be discovered until committed; but the bane of banking is not so much dishonesty as the want of careful management, and the observance of what some sneer at as old-fashioned ideas and methods.

There are two important purposes which the true banker should ever keep in mind: first, to keep, so far as human judgment can suggest, the deposits intrusted to his care absolutely safe; and, second, to return to his stockholders, either in cash or in appreciation of the value of their stock, a fair return upon their investments. The second object is dependent upon the accomplishment of the first. In fact, each is dependent upon the other. They go hand in hand, and if the first is observed, the second will necessarily follow.

No supervision, however wise, able, and close, will make a bank successful or safe if the immediate management of the bank is either dishonest or careless; for, while a supervising officer may correct some evil practices, and may under the law allay some unsafe methods for a time, and may possibly prevent further loss by closing the institution, he cannot do much if the management is not safe, or if it is dishonest. Examinations cannot be made every day. A supervising officer cannot know from day to day the ordinary transactions of the bank, and much can be done by a careless or dishonest management between inspections which may absolutely ruin the institution. A careless management may do many things which will hurt an institution, and still be within the law. It therefore goes without saying, that if a bank's management is either dishonest or careless, or its policy unconservative, failure is almost inevitable.

A bank should be treated as an entity. The varying personal interests, desires, and necessities of individual stockholders should not be considered in determining the proper policy for a bank to pursue. That policy must be pursued which will work for the success of the bank as an institution, as a corporation, as an entity by itself, always keeping in mind, not so much the individual interests of stockholders, as the safety of depositors, and the reasonable accommodation of customers. And, if these two objects are constantly kept in mind, the best interests of the stockholders will as surely follow as the night follows the day.

Any individual who in his private business spends all that he makes, and perhaps more, and makes no provision against a rainy day, is looked upon by all good business men as doomed to ultimate failure. So a bank that spends by dividing among its stockholders all, or nearly all, of its earnings, is sooner or later bound to meet the same doom.

Men seldom, if ever, favor a particular bank with their deposits unless they think that bank is sound and safe. Personal friendship in matters of this kind counts for very little, unless other things are substantially equal. Ninety-nine out of every hundred depositors look at the strength of the institution with which they are asked to do business before opening their accounts. It is therefore necessary, in my opinion, as a fundamental part of the scheme of banking to place the bank upon a basis which will inspire the confidence of those to whom you appeal for business and patronage. Your capital may be large, but even this, if it becomes evident that you are spending all of your earnings, or only carrying that part of them to surplus which the law compels you to do, will not inspire the confidence necessary to permanent success. You must convince the public that you hold the safety of depositors, the soundness and conservatism of your institution, as of more importance than the payment of dividends. I would rather have a large surplus as an attraction to draw business than the most persistent personal solicitation, the payment of dividends, or even the payment of interest on deposits.

A bank can usually make more money with money than an individual, especially if the institution is properly and conservatively conducted, and the interests of the stockholder himself demand that a comparatively large surplus shall be first accumulated before any considerable amount, or perhaps any amount, is returned in dividends. This policy does not involve a loss to the stockholder of anything. His stock is worth just so much more. The earnings are enhanced in proportion, and usually the selling value of the stock of a bank which has an earned surplus of large proportion is much greater in proportion than the stock of a bank with a small surplus, and is usually much more than the book value of the stock. The personal needs of stockholders furnish no good excuse or reason for the declaration of dividends. Any stockholder whose personal needs interfere with a policy which is best for the bank as an insti-

tution has become a hindrance, instead of a help, and should sell his stock and sever his connection with the institution. Any bank which has followed the policy of dividing all, or nearly all, of its earnings, except that which the law compels to be carried to surplus, is not only intrinsically weak, but lacks the confidence of the community in which it is located to a greater or less extent. This rule, I believe, may be applied with few or no exceptions.

A bank which has accumulated a goodly surplus may begin the policy of declaring dividends, and perhaps larger dividends than could otherwise be made; and this without impairing the standing or solidity of a bank. Banking in this respect differs from the business of other stock corporations simply because the public is interested to a much larger degree than in other corporations, and in a different way. Manufacturing corporations do not invite the credit of the public. They have no money on deposit belonging to the public. They do not need to accumulate a surplus beyond their immediate business requirements. They are dealing with their own money; and if one of them fails, the general public is not affected in the way or degree it is in the case of a failure of a bank. A different policy, therefore, must be pursued by a bank. It is not dealing in the main with its own money, but with the money of others; it is the trusted custodian of other people's money. It is therefore its duty morally, and in every other way, to follow that policy which lies nearest the path of absolute safety.

My views upon this subject may seem radical to some, but name a bank which has enjoyed even a reasonable amount of success, and I will show you one which has pursued the policy which I have indicated, and which I advocate. I know there are many banks in my own state which refrain from making any dividends at all until their surplus is large, in some instances equaling their capital. The earning power of a bank should be tested, and should be evidenced by the amount of its undivided earnings, in order reasonably to appeal to the public for confidence; and when this has been done, and when a surplus of sufficient size to afford an adequate safety fund to depositors has been accumulated, then dividends may properly be declared and paid.

Some stockholders seem to think that, unless they get an immediate return upon their money, their investment is a bad one.

They are entirely mistaken. Let me illustrate: A bank begins business with a capital of one million dollars. Beyond the very limited amount which under the law it must carry to surplus it divides its earnings among the stockholders. It may be that the stockholders will average a dividend of 6 per cent., perhaps 10 per cent., upon their investment. The million dollars' capital remains, and the surplus of two hundred thousand dollars, or 20 per cent., has been accumulated. The stock of the bank is worth "120," book value, if no other additions to surplus are made. In most cases, and especially among small shareholders, the dividends are dissipated. They are too small in amount for independent investment. The bank becomes no stronger. If any change is made, it is toward weakness. The bank is not a growing institution, and the public knows it. On the other hand, if this bank pursues a policy of accumulating a large surplus, and of even paying no dividends until the surplus is equal to the capital, the stock is worth "200." Its business increases. It has attracted favorable public attention and consideration. Its earnings become much greater. It keeps adding to its surplus. The bank stock continues to advance in price and value. The stockholder has something to show for his investment, for, while he paid one hundred cents on the dollar, he can sell his stock for two, three, four, or five hundred. The stock of such a bank as this will sell for much more than its book value. Take the Chemical National Bank of New York City, for instance, the book value of its stock is but $2,450 per share; its selling price is above $4,000.

I wish that a concerted move might be made by the supervising state officers throughout the country, and, if possible, that the powerful influence of the Comptroller of the Currency be enlisted, for the purpose of bringing these subjects to the attention of bankers generally in all parts of the republic. The task of accomplishing much may seem impossible, and yet, if we can enlist the efforts of large conservative banking interests in this direction, I believe that much can be done.

I do not wish to be understood as taking a pessimistic view of banking conditions. On the contrary, I recognize the fact that, in spite of the drawbacks to which I have referred, banks are, as a general thing, solvent beyond question, and making money. What

I desire is that a halt be called before the practices which I condemn, and which I believe ought to be condemned, are carried too far.

It is sufficient if interest is paid upon the money deposited for investment purposes; there perhaps is no reasonable objection to this. But commercial deposits should neither demand interest nor be paid it. Dividends should wait upon the accumulation of respectable surpluses. In short, a policy of conservatism and safety should be adopted, and all unsafe and unwise practices be abolished. This, it seems to me, is good business and good sense, and it ought not to be difficult to impress the banking fraternity of the country with its importance.

BANK DEFALCATIONS—THEIR CAUSES AND CURES

BY EDWARD PRESTON MOXEY, EXPERT BANK EXAMINER FOR THE UNITED STATES DEPARTMENT OF JUSTICE AND PRESIDENT OF THE EDWARD P. MOXEY AUDIT COMPANY, PHILADELPHIA.

The banking business offers greater temptations for the abstraction and wilful misapplication of assets than any other calling. This can be explained by the fact that the only commodity dealt in is money, or that which is payable in money, rather than commodities of general use, which to be of any value to the person acquiring them must be converted into money. This conversion is always attended with some difficulty and risk, as the commodity can ordinarily be identified. In the case of money, however, no conversion is necessary and this element of risk is eliminated.

Bank defalcations can be divided into two classes: those for which the officers of the institution are responsible, and those made by the clerical force. The defalcations by officers can be traced to a variety of causes, among which might be mentioned the following:

1. The using of bank's funds to promote enterprises in which the officers of the bank are financially interested.

2. The using of bank's funds for speculation in stocks, grain, cotton, etc.

3. The using of bank's funds for gambling purposes, for betting at the race-track, and for extravagant living.

4. The advancement of the political ambitions of its officers.

5. Negligence of directors in allowing officers to use the funds, under the guise of loans, to a criminal extent.

6. Assistance rendered by the clerical force of the bank through their lack of observation of the criminal acts of the officers or their criminal silence.

7. The want of a rigid enforcement of the criminal laws by the courts.

In a recent address of the Comptroller of the Currency, Hon. William Barret Ridgely, at the convention of the Illinois State Bankers' Association, among other forcible, sound doctrines annunciated said:

> No national bank whose officers strictly obeyed the National Bank Act ever failed—not one. It may almost be said that not one which did not make loans in excess of the 10 per cent. limit has ever failed. The practically universal rule is that all failures are due to excess loans to one interest or group of interests, generally owned or controlled by the officers of the bank itself.
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> In the Comptroller's office, when any question is raised in regard to a bank and the examiner's reports are sent for, the first thing looked at is loans to officers and directors, and then excess loans. If the officers owe the bank little or nothing, and there are no excess loans, it is seldom necessary to look much farther, for the bank is almost sure to be found in good condition. There are rare cases of sudden flight of bank officers, disclosing unexpected forgeries, defalcations, or thefts of money, leaving the bank a wreck; but these are almost invariably the last of a chain of misdeeds beginning with the loaning of undue and illegal amounts by the officers to themselves or concerns in which they are interested.

No one familiar with the subject will controvert the above statement. The examination by the department of justice of our government, made by its expert examiners, of the books of failed national banks, confirms the above statement, and in addition shows that, without a single exception, had there been an expert examination made of the books of the bank, the shortage, by whatever name it is designated, would have been discovered long before it grew to anything like the proportions that many of them did before the bank collapsed.

Among the first things that the average promoter does is to interest some officer of the leading bank in the locality where the business is to be located, or the stock or bonds of the corporation are to be sold to the public. In some instances the officer is pre-

vailed upon to invest all of his available cash in the enterprise, which, in many cases, is a comparatively small amount, but which represents many years' savings from a small salary; while in others he is made a present of a certain amount of the stock of the corporation, which, he is assured and verily believes, will be the beginning of his march along the financial road which will shortly land him at the millionaire's mile-post.

In many cases the bank officer is made an officer, a director, or a member of the advisory board of the corporation, which fact is heralded to the world with all the advertising skill of the promoter, and upon the reputation of his good name many are induced to become stockholders. This is more strikingly the case in smaller cities and country localities, but the large cities are not free from it by any means.

Many a defalcation which has caused the bank's failure is traceable to its officer's interest in some outside enterprise, and the beginning of his downfall dates from the day he made the first investment. One of the main reasons which animated the promoter of the enterprise in financially interesting the banker was that, if at any time the concern required financial assistance, which is invariably the case, it could readily be obtained through him from the bank of which he was an honored and trusted officer. Experience shows that what was at first a small financial assistance soon increases in amount, until the point is reached where it means disaster to all parties interested, if additional aid is not given. Then it is that the demand for money must be met to prevent the bankruptcy of the corporation, which means not only the loss of the money invested by the officer and his many friends, but also the loss of his reputation as a financier and a banker of integrity.

It often happens that, instead of becoming financially interested in new projects or outside business enterprises, the bank officer succumbs to the seductive influences of speculation. He tries his hand in the stock, grain, or cotton market, with the belief that in this way he can amass a fortune in a short time and without effort.

He pursues the same method that is followed by those who buy or sell stocks, grain, or cotton on a margin. His whole idea is to "get rich quick," and in order to accomplish this he either buys or sells the largest amount possible with the smallest amount that his

broker will accept as margin. A slight adverse change in the market price of the commodity or security in which he is speculating wipes out his margin, and a call from his broker for additional margin to carry the transaction must be met. Having exhausted his own money, and being convinced that his ideas as to the future course of the market are correct, he makes the false step of "borrowing" money from the bank and using it as margin with his broker.

It is only a question of time, varying according to the size of his operations and the fluctuations of the market, before he is hopelessly involved and financially unable to return the money of the bank which he has used. He now speculates more wildly than before, and upon a much larger scale, with the hope that one fortunate turn of the market will enable him to make enough money to square himself with the bank. In his case history only repeats itself. He went into the market as a lamb, and in consequence is thoroughly fleeced.

In some cases the gambling-house presents more attraction than the stock, grain, or cotton market, but it is not often that this means of acquiring wealth is resorted to by the bank official, as it is not considered by many as reputable as speculation.

Closely associated with the gambling-house is the race-track, which to some has a fascination that is almost irresistible. The number of persons who bet upon a certain horse to win, upon a "dead-sure tip," can be counted by the myriads. This method of gambling is resorted to to a greater extent by the clerical force of the bank than by its officers.

A large bank in an eastern city was wrecked through the speculation of its president in stocks; another one, through speculations of its cashier in the same market. Some years ago a large bank in the Middle West was wrecked by its vice-president in an attempt to corner the wheat market; while a bank in a southern city was wiped out of existence by its president's and cashier's speculations in the cotton market. The number of cases that could be cited are innumerable, and there is not a section of the country that has escaped. The number of bank wrecks piled upon the financial beach is a silent monument to this truth.

Many bank officers feel that they must maintain a certain social

position in the community in which they live, and to do this many live beyond their income. They attempt to indulge in the extravagances practiced by their wealthier business associates, with the result that they use the bank's money with which to do it. The failure of a certain national bank revealed the fact that its cashier was indebted to it in a sum exceeding one-half of its capital, and that a large portion of the money obtained by him from the bank was used in extravagant living. He maintained a palatial home; his family dressed extravagantly; they entertained lavishly; he kept many fast horses, and indulged in various other forms of expensive luxury. All of this was ostensibly done on the moderate salary he received.

Some bank officers labor under the delusion that to be a factor in the community in which they live they must enter the "political arena." They strive for a high political office. The bank officer soon exhausts all of his own money in his campaign, and next uses the money of the bank which stands ready at hand. The desire for political preferment has turned the head of many a man, and bankers are not insensible to its influence. The ambition of a president of a certain national bank to be the political leader of his party and the mayor of the city in which he lived caused him to use the bank's funds to further that end to such an extent that the bank was forced to suspend, which entailed a severe loss upon its depositors and stockholders.

Bank officers whose directors do not direct are very often tempted into the use of bank funds under the guise of loans. In all probability they would not have broken the law if the persons selected by their fellow-stockholders to hold the office of director had been directors in fact and not in name only. A director is a trustee, and he cannot fulfil the trust he assumes without knowing that the affairs of the bank are being properly administered. How can he do this when he leaves the management almost exclusively to the president or cashier? The number of banks wrecked by its officers because of directors not directing is exceedingly large.

No president, vice-president, cashier, or assistant cashier of a bank can use the funds of the institution for his own use without the same being known to at least a portion of the clerks, and it is either through their wilful silence or through their non-observance

of what is being done in their presence that bank officers are enabled, and in many cases encouraged, to take the funds of the bank. If bank clerks would do their full duty, there would be fewer cases of defalcations by bank officers than at present.

It is an undeniable fact that the laxity with which the criminal laws of our land are enforced by many of the judges of our courts has much to do with encouraging bank officers criminally to use bank funds. They see in too many cases how difficult it is to convict a bank official who has misappropriated bank funds when defended by a shrewd criminal lawyer, and they are therefore willing to take the chances of detection and, if detected, the results of a trial before a judge whose interpretation of the law, the admissibility of evidence, and the charge to the jury are all in favor of the accused. It is only the fear of the law that keeps those from violating it who are not actuated by high motives of right, and judges should be loath to have the charge of the lax enforcement of the law laid at their doors.

While the bank officer is surrounded on all sides by temptation, and some criminally use the bank's funds, one must not for a moment think that they are the only ones connected with the institution who are subject to temptation and who, far too often, listen to the voice of the tempter and become defaulters. Every clerk in the bank, whether he handles a dollar of the bank's money or not, is subject to many, if not all, of the temptations that beset his superior officer. The defalcations by the clerical force of banks can be traced to nearly all the causes enumerated as being the cause of defalcations by officers, and also to a variety of other causes, among which are the following:

1. Temptations offered by loose methods of conducting the business of the bank or of keeping its books and accounts.

2. The lack of proper supervision by officers and directors.

3. The criminal using of bank funds by its officers without detection and punishment, encouraging clerks to do likewise.

Many a bank clerk who has been unfaithful to his trust and has used the funds of the institution with which he was connected for speculation in the stock, grain, or cotton market, or for games of chance at the gambling-house, or for betting at the race-track, or for extravagant living, etc., has been encouraged to take his first

false step by the loose manner in which the affairs of the bank were conducted and its accounts kept. He saw the slipshod way in which things were done by everyone connected with the bank, that clerical errors in the books were not located and corrected, and that general mismanagement prevailed. Is it any wonder that he used the funds of the bank and took the chances of detection with such a condition of affairs surrounding him? The marvel is that, under such conditions, more do not succumb to temptation.

Another cause of defalcation by bank clerks can be ascribed to the lack of a proper supervision of their work by the officers and directors of the institution with which they are connected. The bank may be well managed in all other respects. The officers and directors may loan its funds judiciously and well, be very attentive to the patrons of the bank, and on the alert to add to its already large list of customers. But all of this will not counterbalance the evil results arising from the lack of supervision. The number of defalcations traceable to this cause is undoubtedly large.

In detailing some of the causes of bank defalcations by the clerical force, the criminal using of bank's funds by officers without detection and punishment is one which should not be overlooked. Many a bank clerk who sees the president or cashier of the bank with which he is connected using its funds in speculation or business projects to a criminal extent, and doing so with perfect impunity, as far as the board of directors is concerned, is induced to do the same thing. He sees how easy it is for the officer to get the money of the bank, and he learns the methods he adopts in an endeavor to conceal the fact. He hears of the enormous profits that the officer has made in speculation and what not. He knows that this has been going on sometimes for years without discovery. He therefore concludes that what the officer can do the clerk can do also. He takes a "flyer" in the market and uses the funds of the bank to margin the transaction.

The bank clerk defaulter, when his crime is discovered, is generally brought to the bar of justice to answer for his misdeeds. He is usually convicted. He has no influential associates to use their power to shield him. He has no money or wealthy relations or friends who are willing to furnish money with which to employ able criminal lawyers to defeat the ends of justice. The bank officer,

having what the bank clerk lacks, often escapes the just punishment his criminal acts demand.

The reader must bear in mind that there are no cures for all kinds of defalcations, but they may be reduced to a minimum if banks are properly managed. The cures that are suggested for defalcations arising from the causes discussed are as follows:

1. Directors directing, being more than figure-heads in the management of the bank's affairs.

2. The employing of a sufficient clerical force properly to record the daily transactions of the bank. The non-use of all short-cut methods of accounting which are at the expense of safety.

3. The using of a system of accounting that is surrounded with every known device for safety.

4. The thorough overhauling of the books of every department of the bank by expert accountants at irregular and frequent periods.

5. The realization by directors that examinations made by the official examiner afford little protection against dishonesty of employees, and at best is too hurriedly made to be of much value.

6. Prohibiting bank officers from borrowing money from the bank with which they are connected, except upon the most approved collateral, and the approval of such loans by the board of directors by a formal vote at a meeting of the board.

The number of directors of the banks in the United States who do not direct is much larger than might be supposed, and usually it is the bank where directors are impotent that is looted by one or more of its officers or clerks. Where directors direct, defalcations are almost unknown.

The employing of a sufficient clerical force properly to record the daily transactions of the bank is a cure for defalcations that must not be ignored. Too many officers of our banking institutions are attempting to conduct their business with an inadequate clerical force who, to keep up their work, resort to every kind of hieroglyphic entry that their fertile brain can devise. The non-use of all short-cut methods of accounting, which are at the expense of safety is a cure for defalcations that can be prescribed to advantage. A large number of defaulters resort to false entries upon the books to conceal their shortage. The use of short-cut methods of accounting makes falsifications easier of accomplishment and harder of detec-

tion. Short-cut methods are the bank thief's friend and are welcomed by him. Anyone familiar with the English system of bank accounting knows that such methods are not tolerated, and if our banks, instead of gradually drifting away from the point of safety, would adopt the English methodical methods of recording transactions, they would be better off in the long run. Defalcations in English banks are almost unknown. Does anyone for an instant suppose that the English bank clerk is more honest than his American cousin?

The using of a good system of accounting is undoubtedly a cure for many kinds of defalcations. The system used should contain every known device for safety that the ingenuity of the expert accountant can devise. It should fit the requirements of the business. A system that would be a success in one bank would be a flat failure in another, and vice versa. The volume of the business transacted, the method of conducting it, and the number of clerks employed to handle it are all factors that must be considered in devising a system of accounts. The system of accounting that was used forty years ago, and in a number of cases used to-day, is almost worse than useless. It lacks the safeguards which the improved systems of to-day provide.

The thorough overhauling of the books of every department of a bank by expert accountants at irregular and frequent periods is considered by those who have made a study of the subject as being one of the best, if not the very best, cures for defalcation that can be suggested. Comptroller Ridgely in commenting upon this subject, in his address previously referred to said:

> The directors should have frequent thorough examinations made by committees of the board or experts employed for that purpose. These should be made independently of the active officers of the bank and, with all the incredulity of the proverbial Missourian, everything should be shown and no man's word taken for anything.
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> Every clerk and every officer of the bank should be examined and checked up as thoroughly as possible, and required to show the examining committee or the auditor just how the matters in his charge stand. No man who is in a position of trust has any right to resent such an examination, and one who has a proper appreciation of the relation he bears to those who have reposed trust and confidence in him will welcome such an opportunity to show that he has been faithful and efficient.
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> If all boards of bank directors would do their full duty in the way here outlined, bank failures would almost come to an end. Banks would, of course,

make losses, and occasionally one might fail, but it would be rare, and the result of very unusual bad judgment and incapable management. We should very seldom have such sudden and sensational failures of banks, looted from the inside by men who have stood high in their communities, and even thought to be models of honesty and trustworthiness.

Hon. James H. Eckels, ex-Comptroller of the Currency and president of the Commercial National Bank of Chicago, in speaking upon this subject, said:

I believe that a bank cannot make a better investment than to have an independent audit made by an expert, for the benefit of both the officers and the directors. To such independent audits can be given more time and a more complete analysis of the condition of the bank being examined than under the ordinary examination made by the directors without the aid of an expert.

Hon. Charles G. Dawes, ex-Comptroller of the Currency and president of the Central Trust Company of Illinois, of Chicago, expresses himself upon this subject as follows:

In reference to the advisability of a periodical examination of the affairs of banks and trust companies, made by experts, for the benefit of the officers and directors of such institutions, I will state that I deem such a course as most advisable. While in the larger cities the public examiners have, as a rule, a compensation sufficient to enable them to make a proper examination, the National Banking Act, in its provision for compensation of examiners outside of the central reserve cities, in effect places a premium upon hasty and incomplete work. This defect has been recognized by most of the Comptrollers of the Currency, and the attention of Congress invited to it. However, both in the central reserve cities and elsewhere, a periodical examination by experts of the affairs of banking institutions I deem important.

The examination by the expert accountant furnishes an additional protection to the banker against dishonesty; it is a necessary supplement to the work of the official examiner; it improves the tone and efficiency of the working force; it improves the system of bookkeeping; and it increases the confidence of the depositors and stockholders.

Few realize in how many ways a bank may be defrauded by its officers or clerks. A large volume could be written on "how to rob a bank" without exhausting the subject. There are few banks in the United States which have not suffered some loss from the dishonesty of an officer or clerk. Why will banks wait until they have sustained a severe loss through the dishonesty of a trusted employee before having their books examined by an expert account-

ant? To the prudent business man the question is unanswerable. There is no bank which does not receive full value in the security of its business for the money which it spends on an audit by an expert accountant.

The official examinations as now conducted are of little value against the dishonesty of employees. They are not thorough enough and are too hurriedly made. There are 75 national bank examiners in the United States to make 10,914 examinations each year, or an average of 145 to each examiner. Assuming that all the examiners are steadily employed every day in the year, excepting Sundays and legal holidays, when the banks are closed, they can devote on an average only two days to each examination. Even the largest banks, with hundreds of employees and thousands of accounts, are examined in a few days.

The audit of bank books by expert accountants is a comparatively recent development, but it is rapidly being adopted by conservative bankers everywhere. It furnishes the best safeguard against dishonesty, the best means of improving the administrative service of the bank, and is a strong bid for public confidence and support. The bank that surrounds itself with every safeguard is in the strongest position to command the banking business of the community.

NATIONAL BANK EXAMINATIONS

ADDRESS DELIVERED BY JOSEPH CHAPMAN, JR., CASHIER, NORTHWESTERN NATIONAL BANK OF MINNEAPOLIS, BEFORE THE SOUTH DAKOTA BANKERS' ASSOCIATION IN JUNE, 1905.

THE subject of national bank examinations has received quite a little attention of late through the failure of some institutions where the national bank examiner has been held by the public generally to have been at fault. The time has come when the bankers of the country ought to look the question of examination squarely in the face, and ascertain whether or not it is possible for the department at Washington to give us different examinations from those it is now giving. Among many bankers the national bank examination

has come to be looked upon more or less as a farce. There is no question but that the directors of banks feel that as long as the national bank examiner reports that the bank is all right there is no cause for them to worry, and the depositors feel likewise that their money is safe. The reason that both the directors and depositors feel safe is probably because they are familiar with Section 5240 of the Revised Statutes of the United States, which states that, "The Comptroller of the Currency, with the approval of the Secretary of the Treasury, shall as often as shall be deemed necessary or proper, appoint a suitable person or persons to make an examination of the affairs of every banking association, who shall have power to make a thorough examination into all the affairs of the association, and in doing so to examine any of the officers and agents thereof on oath, and shall make a full and detailed report of the condition of the association to the comptroller."

The office of the Comptroller of the Currency is a political office. The selection of a man to fill this place is left to the President of the United States, and he may or may not be a man who is fitted by education, training, and bent for that most important position. I do not think that the importance of the possibilities of this office are appreciated by the bankers and by the public generally. It is a position calling for the highest order of executive ability, discretion, tact, and backbone. It is a position that should pay a salary commensurate with the responsibility of the office. At the present time this is not the case. The salary is small and the man filling this position is very apt to correspond with the salary. The country has been most fortunate in obtaining men of high character who have filled this post with great honor to themselves and to the banking profession. However, as long as the office is a political one, given as a reward for labors performed, there is danger that the man who holds this important position will be susceptible to influence.

But the curse of politics in the appointment of the Comptroller of the Currency is secondary to the far more important matter of the appointment of the national bank examiners themselves. No matter how good a man may be in the office of comptroller, he is powerless to appoint his assistants. These men are nominated or appointed by the United States senators from the different states, and the only qualification that appears to be necessary to get the

appointment of national bank examiner is that the person applying should have a political pull and influence with the senator. The question of ability and fitness is lost sight of in the eagerness of the senators to regard their friends and scatter plums to the faithful.

To a convention of bankers this statement is no news. To the public generally it may be. In anything I say I do not wish to be classed as sensational or revolutionary; but I believe it is time that we talk these matters over seriously, in order, that some method may be devised whereby the entire machinery of the control and supervision of national banks of this country may be removed from politics, so that we can get men, from the comptroller down, who shall be selected simply for their ability and fitness to perform the work, men who shall be kept in office as long as their work is satisfactory, and men who shall be paid a salary commensurate with the responsibility they assume and the labor they perform.

It is to the credit of the national banking system that it has forged to the front, and made itself a power in this land, in spite of the loose methods provided by the government for its supervision and its control. It is to the credit of the officers and directors of national banks that their institutions are in such excellent shape, regardless of the namby-pamby national bank examination. In order that we may understand how ridiculous and silly the performance called a national bank examination really is, it is necessary for us to read a few figures.

According to the report of the Comptroller of the Currency, dated March 14, 1905, there were in operation in the United States 5587 national banks. Each bank is required to be examined twice a year, which makes the total number of examinations in one year, 11,174. The totals represented by these 5,587 banks are as follows:

RESOURCES	
Loans and discounts	$3,888,233,694.79
United States and other bonds	1,216,374,365.74
Banking house furniture and fixtures and other real estate	148,663,931.83
Cash and due from other banks	2,054,855,693.80
Total	$7,308,127,686.16
LIABILITIES	
Capital	$782,487,884.67
Surplus and profits	603,555,715.08

Circulation	430,995,523.00
Bonds borrowed	34,810,906.69
Deposits	5,427,239,316.68
Other liabilities	29,029,340.04
Total	$7,308,127,686.16

To examine and audit and report to the boards of directors and to the depositors in these 5587 banks, there are employed seventy-five men on a commission basis. In other words, the examiner gets a certain amount of money for the capital and total footings of any bank. If he can examine a bank with two million dollars' worth of assets in one day, it is to his interest to do so, for he gets no more money if he takes a week, two weeks, or three weeks to do this work. To any thinking man the idea of seventy-five men making 11,174 examinations of banks, whose total deposits amount to $5,427,239,316.68, would be ridiculous were it not that it is not even necessary that these seventy-five men have any knowledge or experience in auditing; they simply have to have a political pull. This is probably one answer to the question which is heard so many times, when anything goes wrong in a national bank: "Where was the national bank examiner?" Most likely he was consulting his railroad schedule, seeing how soon he could get out of town, examine another bank, and make another commission.

In order to satisfy myself as to the length of time it would take an expert accountant to do similar work, I have asked a firm of New York accountants for some figures, showing the time necessary to make an audit of the accounts of a bank of the following total footings:

	Accountants.	Assistants.	Time required
$200,000.00	1	1	10 days
500,000.00	1	1	18 "
1,000,000.00	1	2	25 "
2,500,000.00	1	3	30 "
5,000,000.00	1	4	35 "
10,000,000.00	1	4	45 "

Of course this estimate is only approximate, and is intended to represent the time it would take this firm of accountants to render a report that would be satisfactory to themselves and to the board of directors that hired them to make a first examination. But owing to the changes in the national bank examiners a good many of

the examinations given national banks are first examinations. This first firm of public accountants advise me that the time would be considerably lowered on a following examination if the first had occurred within six months.

In my own bank the national bank examiner appears on a Saturday noon, and has finished by the following Friday afternoon. He brings no assistant with him and appears to be quite satisfied that everything is all right. I note that by the figures given me by the expert accountant, it would take one man and four assistants forty-five days to make the examination of a bank considerably smaller than the one of which I am an officer. In Minneapolis we have a state bank with total footings very similar to our own, and in talking with the state department I find that they send two men to make this examination, and it takes the two men three weeks. Whenever I have been able to make a comparison between a state examination and a national bank examination, I have always found (at least in the state of Minnesota in the last four years), that the state examination was superior to the national examination. But as I believe in talking only about those things that a person actually knows, I have not attempted to touch on the subject of examinations made by the state department. It is no doubt subject to improvement, but I believe that in Minnesota, at least, it is on a higher plane than the national bank examination. This is due, in my opinion, largely to one thing, and that is that whereas the national bank examiners are on a commission basis, the size of their commission depending upon the size of the bank that they examine, the salary or compensation of the state examiner is fixed by law at a certain sum per year, putting them on a regular salary basis, so that it is a matter of indifference to the state examiner whether it takes him one day or ten days—he stays with the bank till he is satisfied with the examination.

It is time for the directors of national banks in this country to disabuse themselves of the idea that an examination by a government official is all that is necessary in order that they should know that the bank of which they are directors is in the condition reported by the active officials of the bank.

It would be worse than idle talk were a person to make the statements made above and propose no remedy. There are practical reforms that can be adopted in the present mediaeval bank examina-

tion which would materially lessen the stockholder's liability and increase the depositor's safety.

First and foremost the fee system should be abolished. The examiner should be appointed by the Comptroller of the Currency without any dictation from political sources, should be placed on a regular salary basis, and there should be enough bank examiners appointed to do the work properly. What this number should be I would not even care to guess, but I am absolutely certain that the number now employed is so small in comparison with the number that should be employed, that were this plan to be put into effect, there would be nearer two hundred and fifty than seventy-five.

Secondly, these bank examiners should be appointed because they have some ability—because they are fitted for work of this kind, and they should have suitable provision made for assistants. In my own bank, not very long ago, it took three expert accountants three weeks to do what it took a government examiner less than one week to do. It is impossible for a man to examine a bank of any size intelligently without taking an assistant in with him, for the reason that while the examiner is examining one department, the officials, if they care to, can switch the collateral or the assets in such shape as to defy and bewilder the most astute examiner. This is avoided by taking a requisite number of men at the time the examination is started and practically taking control of the bank, when it is in a normal condition.

The practice of having the national bank examiner go over the paper to ascertain its value with an officer of the bank who made the loan is an absurdity. This is where the directors' part in the bank should be made prominent. The directors' names are loaned to banks to give them an air of stability, of strength; yet the directors sign sworn statements knowing absolutely nothing of their own knowledge of the figures therein contained, and the bank examiner seldom, if ever, consults them as to the value of the paper representing the loans of the bank. In every examination either the board of directors, or a committee from the board of directors, should be called in by the national bank examiner; and he should question them concerning the value of the paper, and not rely entirely upon the statements made to him by the active officer who made the loan. It is not a felony for an officer of a national bank to deceive or lie

to a national bank examiner, unless the said officer is put on oath. It would do the directors of a bank good to go over the collateral personally with the examiner every six months. I know of no practical way in which they could keep as closely in touch with the character and quality of loans made by banks of which they are directors as in this simple way, and I am certain that it would add a great deal of value to the government examination.

Regarding the signing of the names on the sworn reports, I doubt if there are many directors who ever take the trouble to look at the books of the bank and satisfy themselves that the figures represented on the statements are correct. I doubt if the majority of directors in national banks understand that the individual deposit ledgers are not audited at all by the national bank examiners. The figures on the pages are gone over, footed up, but no verification is ever asked from the depositors as to the correctness of their balances. This is done in the case of bank accounts, but not in the case of individual deposits, nor would it be practicable under the present way of doing business for the national bank examiner even to attempt to audit the individual ledgers. In this department and in the collection department the public accountants spend most of their time—the departments that are practically avoided by the government examiner. The usual place for defalcations to exist among bank clerks is on the individual ledgers. The temptation is made easy by the use of the pass book system. There is no more reason why a reconcilement should be taken for a bank balance as to the correctness of the amount of money due them at the end of any one month, than there is to take a reconcilement from an individual depositor. Both represent money, both represent trust money. The use of the statement system on individual accounts has an excellent moral effect on the force of the office, and it enables the officers and directors of the bank to know that the individual ledgers are correct and represent the actual amount of money due the customers.

The above are three practical suggestions, from my own point of view, as to how the government examination can be bettered.

There are certain things that the directors of banks can do themselves, which would materially help the government officials; and the first and foremost is that no man should allow his name to be

used as a director of a national bank who does not intend to direct. Figureheads are of no practical use and are a positive detriment in the banking business. The day of one-man banking is past in this country. No matter whether a bank be private, state, or national, no one man knows it all, when it comes to investing other people's money. Comparatively few men make a success individually in investing their own money. How then can one person be capable of investing the savings and accumulations of a number of people? I have heard it stated time and again by both the State Superintendent of banks and national banks and the Comptroller of the Currency, that no national bank or state bank has ever failed when the directors have done their duty.

Just what the duty of a director is is a most important question. I am a firm believer that what is left to five or ten or twenty men to do, is not so well done as what is left to one person. For that reason I believe the active officials in banks should run the banks and have considerable to say as to what the policy of the banks shall be. I believe firmly that the advice and counsel of five or ten or twenty men is valuable to any active official in the bank, and ought to be sought for by that official and not avoided. In other words, I believe that it is the duty of the directors to advise, to consult; that it is the duty of the officers to carry out the policy outlined by the board of directors; and if that policy or advice cannot be followed consistently by the officer, then it is his duty to resign, because it is the directors to whom the depositors are looking for the safety of their funds entrusted to the bank. That is the duty of the directors to the officer, and of the officer to the directors.

The directors have a duty to perform towards themselves, and I know of no way that they can discharge that duty intelligently other than to have an expert examination of the bank in which they are directors, at such time and in such manner as they deem best, with no knowledge whatever given to the active officers of the bank as to when that examination shall be made, and the report of said examination to be made to the directors themselves. This matter is one which simplifies itself according to the size of the bank. The smaller the total footings the simpler the examination, the easier it is for the directors to satisfy themselves that everything is correct.

It is also the duty of the directors to know whether or not the

officers of their banks are engaged in speculative ventures, and are giving more time to outside business affairs than they are giving to their own bank; for I believe firmly that the time has gone by in large institutions, when it is possible for active officials in banks to give their best attention and energy and interest to the business of their bank, if their attention is absorbed by their personal interests elsewhere. Either the business of the bank should be important enough and the remuneration sufficient to attract active men to fill these positions of trust; or the officials whose attention is on outside matters should be permitted to devote their entire time to their own affairs, without the annoyance necessarily entailed upon them by devoting any attention to the interests of the depositors who are leaving their funds with them, under the impression that they are being safely looked after.

What we need in the banking business to-day more than anything else is some old fashioned men, with high ideas of honor and integrity; whose minds and attention are not all taken up with getting rich quick; who will give their entire attention to the business of running the bank in the interests, not of themselves or of a clique with whom they happen to be associated, but in the interests of the people who place their savings with them.

In conclusion I wish to state that while I believe the methods employed by the government in examining national banks should either be materially changed, or the government examination abolished altogether, I do not believe in shifting one's responsibility to the government, as I am no believer in paternalism. The matter of a safe conduct of the national banking business does not rest upon the government officials; it rests upon the directors in the national banks, who must discharge their obligations to the stockholders who elected them, and to the depositors whom they represent, in an honorable, businesslike, and up to date manner.

WHERE WAS THE BANK EXAMINER?

ADDRESS DELIVERED BY S. R. FLYNN, PRESIDENT OF THE NATIONAL LIVE STOCK BANK OF CHICAGO, BEFORE THE ILLINOIS BANKERS' ASSOCIATION, AT PEORIA, SEPTEMBER, 1902.

THE national-bank examiner is not perfect, but he is better than he was, and can be made better than he is. The past decade shows vast improvement in the character of service rendered by examiners. Further improvement is possible as to men and methods, but perfection is no more possible in the field of government inspection than in any other department of public or private business, where men and the methods of men prevail. It is the fashion in some circles of darkness to attribute to the examiner all the ills that result from bank failures. In fact, it is no exaggeration to say that there are some who still hold the opinion that the national-bank examiners were the responsible cause of the panic of 1893. The question, "Where was the national-bank examiner?" was the stereotyped query of 1893. Every time a national bank failed it was: "Where was the examiner?" Some presumably intelligent people were rather inclined to the belief that if the bank examiners had done their full duty there would have been no bank failures, indeed no panic. If the national-bank examiner could perform a modicum of the service demanded by unreasonable critics, it would be difficult to compensate him with earthly rewards, in cash or honor. However, earthly reward has been, is now, and always will be quite sufficient to compensate the examiner for all he can do and for all that reasonable men will expect him to do.

There was a time, not so very long ago, when the examiner made his report on a piece of paper no bigger than a postage stamp. In those days banks were not examined; they were merely viewed. Indeed, they were not always viewed. Not infrequently the visiting examiner arrived and left on the same train, contenting himself with five minutes' conversation at the railroad station with an officer of the bank. The examiner had wired ahead instructing the officer to meet him at the train and to bring him a trial balance. There have been cases, where the examiner did not even visit the town. He made his examination by correspondence, avoiding the tedium of travel. Strange that bankers submitted to such imposition! But then, some of them did not want to be examined, while others

regarded the examiner as a necessary political evil. Therefore few voices were raised in protest.

The true aim and purpose of an official examination is not generally understood. Many examiners have no better understanding of their duties than their most superficial critics. The examiner is not supposed to act as a detective. Many critics think him useless in any other capacity. A few of the examiners, embryo sleuths, veritable Sherlock Holmeses, delight in dark, mysterious methods in processes of deduction that uncover many mare's nests. Some of the detective species, owing to defective early training, or natural brutality, act like Bowery policemen. It is a wonder some of these are not thrown into the streets by insulted bankers. There is nothing in the rules and regulations of the Comptroller's office prohibiting an examiner from being a gentleman and acting like one. The gentleman detective is not offensive. He is regarded as an amusing diversion by bankers having nothing to conceal. If there is anything to cover up, ample time is afforded for concealment while Sherlock is deducing.

There are some examiners, sad to relate, who seek to win the favor of bankers by slighting their work. To express it bluntly, they want a bank job. We may tell them with truth that they will never get one by show of leniency. The properly constituted bank officer demands a rigid examination. The properly constituted bank examiner will make no other kind. The examiner and the officer fully realize that in auditing the accounts it is not possible to do much more than skim the surface. In examining the books, the accounts, the system, if the examiner gives the bank the benefit of his broad experience by suggesting necessary improvements, he has done his full duty. No matter how rigid an examination, how excellent the methods of an examiner, all his precautions will prove impotent to prevent the manipulations of a practiced thief. The examiner can suggest a way to make stealing difficult. He can provide you with safeguards, checks, and counter-checks, that will render wrong-doing extra-hazardous, insuring ultimate discovery; but if you have a thief in the bank, he will rob you, despite your efforts, the efforts of the examiner, and despite every safeguard human ingenuity can devise. This is a disheartening truth. So don't ask, "Where was the examiner?" when a defalcation is dis-

covered. Perhaps, while not making the discovery, a suggestion from him made discovery possible. But when a thief is discovered by the examiner, don't stultify yourself, as many bankers do, by rendering the criminal all possible aid. An examiner has seldom made criminal charges against a crooked bank officer or clerk without regretting the action. Usually before the trial is at an end he wonders whether he himself should not be in the prisoner's dock in the culprit's place. The most insulting, brutal insinuations are thrown at him by the attorney for the defense, and the judge permits it. As a rule, either the grand jury, the trial jury, the prosecuting attorney, or the judge, through mistaken sympathy or ignorance, is determined to free the culprit. I know of one case where the accused had robbed the bank for six consecutive days, using the same method of concealment, and the judge took the case from the jury, declaring it might have been a "consecutive coincidence." I shall never forget that expression. The criminal was accused of robbing his next employer. I presume this was another "consecutive coincidence."

The chief purpose of an examination is to test the solvency of the bank under examination. I know bankers are accustomed to laugh at an examiner's attempt to estimate values. But let me tell you this: Any proper examiner, with a credit head on his shoulders, after examining a city bank four or five times, will have as good, if not better, idea of the value of its assets than the average officer. Let me tell you, further, that a first-class examiner, a good credit man himself, visiting any bank for the first time, conceding that his questions are answered truthfully, will make an estimate of value more nearly correct than the man who made the loans.

The examiner of to-day who does his duty does not have a sinecure. He comes to a bank unannounced. He takes complete charge of the assets, holding them until he has checked them, and yet not in the slightest degree interfering with the business of the bank. He proves the cash. He lists and proves the loans and discounts, the collaterals, the stocks and securities, other real estate and loans secured by real estate. He takes the trial balance and checks it. He balances the ledgers, proves all the registers. Then comes the hardest task, if he is a conscientious man—formulating data for his report. He has the trial balance, and this forms a part of his report.

Then he lists the directors, with their direct and indirect liabilities; the officers and clerks, with their direct and indirect liabilities. He reports on the character and capacity of the management. He describes the system of accounting. The loans and discounts are segregated into five classes. Over-loans are listed and described. Past-due paper is segregated from live paper, divided into two classes and described. Overdrafts are criticised. The state of the reserve is given. Securities, other real estate, and mortgage loans are listed with their book and market or estimated values. The deposits are analyzed. Habits of borrowing are stated. Then comes a general statement showing the condition of the bank. An estimate of the value of assets is made, and if an impairment develops, an assessment is recommended. Values are ascertained in the way common to bankers.

The report can now go forward, but the examiner's task is not at an end. Statements have been sent to correspondent banks for reconcilement and report to the examiner. Items in transit are being checked by correspondence. All these reports have to be checked. Then there is his line-book. The city examiner keeps a record of the aggregate of the paper of different concerns carried by the banks on his list.

If a bank examiner does his duty—and most of them do—who will say his position is a sinecure?

While a city examiner has more work to do than his country brother, he can feel better satisfied with results. He has a distinct advantage in estimating values. He has a distinct advantage in checking bank accounts. The country examiner cannot very well send out bank statements for reconcilement. Under present conditions he is compelled to use the foolish little circulars provided by the Comptroller's office. It is absolutely impossible to reconcile an active bank account with one of these. There was an examiner who claimed he reconciled accounts to a cent with these circulars, but that examiner has not had a credit balance on St. Peter's books since. One banker, whom I had evidently annoyed by frequently sending him one of these circulars, returned one without any information other than the following communication:

This report does not give us one cent worth of benefit. If the examiner would send us a report of the result of this report with the banks in question,

also give us a guarantee report of the condition of these banks after their examination, the examiner to give a good bond to reimburse the outside bankers in case of failure of the bank, I would be willing to concede to give reports every day or month; but as it is, it is only a scheme for a few people to draw salary without benefit to the class intended.

This is given verbatim ad literatim.

The present examination covers the ground very thoroughly. If the examination made is not complete, you may be sure the examiner has not followed instructions. If an examiner merely carries out instructions, he will give an examination as nearly perfect as may be under existing conditions. The same methods would give better results if more time were devoted to their application. This is generally conceded, and the recommendation that examiners be placed upon a salary basis has been frequently made. Perhaps it has never been adopted because it is so palpably worthy of adoption. More time should be devoted to examinations, but an examiner cannot be justly blamed for not giving this time at his own cost. Many examinations are now made at a cash loss to the examiner. Give the examiner salary and expenses, and let him use present methods, and he will show you results that will amply offset any additional expense. For instance, now that statements of individual accounts are kept up to date, they could be checked just as bank statements are. The country examiner could check individual accounts and correspondent bank accounts, just as the city examiner now checks the bank accounts.

But if these precautions were taken, what protection would they afford against a confederate depositor? And it is, "Where was the bank examiner?" when we hear that a clerk and a depositor have, by their joint effort, succeeded in robbing a bank. But there is one comforting thought that may be cherished by the much-maligned bank examiner. No accountant asks, "Where was the bank examiner?" The query comes from those who do not know the difference between a ledger and a coal scuttle. The expert accountant knows how easy it is to manipulate accounts so as to fool another expert accountant, and he is, therefore, humble. He is slow to criticise another accountant. The ever-ready critic, however, never lets facts worry him. Nor is he at all concerned about his inconsistencies. The Monetary Commission gives an illustration of the pitfalls in the way of the unthinking critic. On page 357 of the

commission's voluminous and valuable report may be found the following:

> At present the ordinary examinations are largely formal and of little value so far as any real indication of the character of the discounts is concerned. Being made by persons who are strangers to the locality, and hence unfamiliar with the business paper of the place, they cannot afford any important information as to the real situation of the banks.

Look on that statement, and then on this, printed on page 360:

> The rumors that examiners ask and receive honorarium suggests a state of things inconsistent with accurate examinations, and there is opportunity for other abuses of the same sort which should be corrected. The commission has, therefore, recommended that bank examiners be paid adequate fixed salaries, according to some uniform rule, thus avoiding all excuse for the payment of additional emoluments by banks to examiners. It has been suggested that the loaning of money by banks to examiners be forbidden under penalty, and, to avoid as far as possible the risk of violation of the law, that the examiners be assigned to banks in rotation.

An examiner, a stranger to the locality, being unacquainted with the business paper of the place, "cannot afford any important information as to the real situation of the banks;" therefore, rotate the examiners. That is absolutely funny. To prevent dishonest examiners and dishonest bankers from being dishonest, destroy the efficiency of honest examiners and deprive honest bankers of the protection afforded by a proper examination.

The unwarranted attack upon the honor of the examiners I have just quoted would be treated with the contempt it deserves, were it not given such high endorsement. The examiner has reason to feel proud of the record of his associates during the past decade. The average members of the Monetary Commission were inspired by patriotic purpose, but in no higher degree than the average examiner. There have been unworthy bank examiners. I believe there have been unworthy college professors; but the examiner is not prepared to condemn all college professors, nor to recommend that they be rotated from chair to chair because a few of their number have sinned.

The efficiency of the examiner can be increased by giving him salary and expenses, but not by rotation. Every examiner and every banker knows that no man can make a satisfactory report on the assets of a bank before his third or fourth examination. At the moment he could make a good examination, the commission would

move him to another district. Such a recommendation is ridiculous. No, do not rotate dishonest or inefficient examiners—discharge them.

Politics should be a stranger in the Comptroller's office. The efficiency of the service has been greatly increased by the partial elimination of politics from its operations. The service would be still more efficient if politics were wholly eliminated. Every appointment from comptroller down should be based solely on merit. The Comptroller should be a man of ripened judgment, the possessor of demonstrated common-sense, or he should be a brilliant find. The examiners should be men of broad experience, or none at all. There is no place on this force for narrowness, developed or undeveloped. The tenure should be good behavior and efficient service. The salaries should be sufficiently large to anchor men of average ability to the positions.

There should be two supervising examiners. The clerk in charge of the reports division should not be a clerk—he should be chief of examiners. He should have had experience as an examiner, and he should know as much as, if not more, than the average examiner in the field, and he should receive full cash value for his knowledge. Much of the best work of the examiners goes to waste because it is never viewed by intelligent eyes. The significance of important information is not appreciated, and therefore is not called to the personal attention of the Comptroller. Mishaps that might have been avoided follow, and the examiner suffers personal humiliation and public condemnation in consequence. It may be asserted, without fear of successful contradiction, that the reports of the Comptroller's examiners, excepting a very few of the examiners, present the condition of banks with faithful accuracy. If properly analyzed and promptly acted upon, many bank troubles might be averted.

In this connection, however, bear in mind the grave responsibility resting upon the Comptroller's shoulders. It is easy to recommend closing a bank, but his action is final and he must be sure he is right before going ahead. You know the mere act of closing a bank's doors causes a shrinkage in the value of its assets. Therefore, the Comptroller is not likely to order the closing until it becomes absolutely necessary. The public will never know how many lame and halting institutions have been restored to health and vigor by the efforts of the Comptrollers and their assistants. The public hears

of the lost banks only. The public seldom knows that a bank is in bad condition until all efforts of the Comptroller's office to save it have failed. And remember this, that no matter how skillful the Comptroller and his assistants, they cannot prevent inefficient officers from making bad loans; they cannot stand at the elbow of the loan man during every minute of the business day; they cannot prevent a dishonest officer or clerk from stealing, for they cannot pick out prospective thieves and watch them night and day. Bad loans and steals may be discovered, but they cannot be prevented.

SUPERVISION AND PUBLICITY

ADDRESS DELIVERED BY J. A. S. POLLARD, CASHIER OF THE FORT MADISON SAVINGS BANK, FORT MADISON, IOWA, BEFORE THE MISSOURI BANKERS' ASSOCIATION AT KANSAS CITY, MAY, 1905.

We have heard much talk about such national regulation and supervision of railroads, which have become national in their influence and operations, as will render justice to shippers, big and little. There is a demand for federal supervision of the life insurance companies in which such immense sums belonging to the people are invested. I see no danger to free institutions in federal regulation of rates charged by the great public utilities; and why any institution, be it life insurance company, trust company, or private bank, asking for the unrestricted investment of the public dollars, should not have every safeguard of legislation which experience has proved conducive to the interest of bank depositors, is beyond the comprehension of a few million citizens who claim to possess average intelligence. As a rule banks are under supervision of either national or state authority; all of them should be under legal regulations, for they are to some extent public institutions for the custody of the people's credit. The bank's charges are regulated by state laws with penalties for excessive rates. It is eminently right that the banks should be under supervision and regulation, and there is no sound reason why immense corporations, doing a larger business than any bank, reaching in their scope not merely a limited list of depositors, but practically the entire population of the country, should

not be required to take the three degrees of supervision, cash capital, and publicity, and ride the same legislative goat so familiar to the banking fraternity.

The greatest value of supervision by official legislative authority, is in the publicity entailed. Publicity is one of the greatest modern remedies for financial ills. It is only another name for commercial information, and few banks have ever suffered losses which might not have been avoided by complete and accurate information. It is the handmaiden of public opinion; it prepares the way and makes effective our great governing force.

The lazy man was directed by high authority to visit the ant and learn the lesson of industry, and the man who fears publicity can be escorted to the bank where a working model of publicity is in successful operation without revealing any craft secrets.

Had the trusts and combinations been subjected to the same publicity, inspection and supervision as the bank, many of those which have caused our financial equilibrium to wobble at times would never have been able to float their securities on the troubled sea of commerce. Both nation and state demand the right to supervise and regulate the banking business, and what we need to separate the good trust from the bad is the same magnifying glass, tests, and scales as are now employed with banking institutions.

I should have said—with the majority of banking institutions, for in some of our states, with excellent laws governing state banks and the national banks of course under federal supervision, the solons, through utter lack of legislation governing private banks, have held out chromos to the men who chose to compete with legally supervised banks without subjecting themselves to any of their restrictions. The supervision or regulation of private banks has been the subject of considerable discussion and comment lately, particularly in the West, and bankers in every state should realize that it is the concern of bankers everywhere to have every institution conducting a regular banking business under proper supervision and publicity; for a lack of controlling legislation too frequently gives the opportunity for improper banking, and improper banking hurts business in every state. It disturbs the principle of faith in humanity, that credit which is the basic principle of the grand action we call business—the scientific direction of profitable human energy.

In Iowa, if a private banker choses to do business without capital, or advertises more capital than he has, he is regarded as an enterprising citizen. If a banker governed by state law does the same thing, he goes to the penitentiary. If a private banker owns enough government bonds, and often even if he doesn't, he can escape all taxation, but the state banker has not that privilege. If the private banker wants to please his farmer friends by carrying their loans in the shape of over-drafts—and nothing pleases an Iowa farmer so much as to be able to say, "I can write my check on a shingle and the bank will pay it if I haven't a cent to my credit" he has no one to question him; but if the national or state banker does that he gets censure from the authorities. If the private banker wants to loan everything he has in the bank to an individual, or invest in real estate or mortgage his safe, he can do so; but the supervised bankers have legal restrictions; so that by subjecting yourself to the excellent state and savings bank laws of Iowa you are denied a dozen rights, both valuable and questionable, which the private banker possesses, and you pay the expense of incorporation, examination, taxation, and published statements for the privilege of getting a legislative "double cross."

Gentlemen, I believe in personal liberty and am too mean a democrat to advocate strong federal control and centralization of financial power in government; but I am with those who are jealous of forfeiting commercial liberty for an equally dangerous brand of financial concentration; that is, leaving our vast inheritance of wealth unrestrictedly in the hands of a few men whose minds are warped and diseased by an uncontrollable craze for large footings, and I do believe in the government taking a hand wherever necessary to administer justice; that both state and nation should exercise the police power over us impartially and enforce the laws rigidly. I believe the individual citizen has the right, if he is persistent and his friend is indifferent, to borrow all the money he can—it's none of our business, provided it is obtained without misrepresentation and not loaned in ignorance; but I am just as positive that from the commercial discounts of the East to the cattle paper of the West, from Minnesota warehouse receipts to the southern cotton-bills, every man desiring to handle the people's funds as a banker should be subjected to examination, supervision, and regulation and required

to publish sworn statements for the information of those who entrust their hard earned dollars to him for the safety and convenience which the common acceptance of the word "Bank" seems to promise.

I do not wish to reflect upon the honest, well-meaning and uninspected private banker whose sterling integrity and personality enable him to obtain the people's deposits without the capital nor upon the really responsible unsupervised banker who does a safe business and whose only objection to regulation and publicity is that he has been handling the people's credit so long and so independently that he has come to regard it as his own, and hates to be bothered; but I maintain the principle is sound, that the safeguards of legislation—safeguards which have shown in hard, cold statistics that supervision and publicity mean fewer failures and even in occasional failures more ultimate return to creditors,—that these safeguards should in every instance be afforded the public which must entrust its credit to the banker, and that no man should be permitted to hang out the sign, "Bank," who is not willing to experience a friendly visit from a competent examiner and swear to and publish reports of the condition of his institution. In my state a private banker cannot use the words "Savings" or "State" any more than he can the name "National," and there's an obvious intent that the public must not be deceived into thinking that he is running a bank under state supervision. For practically the same reason he ought not to be permitted to use the more important and more easily misunderstood title "Bank," under the present lack of governing laws. This is a free country, I admit, but if one desires to do business without supervision, publicity or legal restraints, there are various avenues of trade and commerce open with only the common law to interfere.

Your ordinary citizen would not, if he knew it, shoot skyward in an elevator which had not been inspected by a qualified examiner and had not a published report of its condition hung up in the cage; he would not sit peacefully in his office if he knew that just below him was an uninspected boiler and nothing standing between him and eternity but the personal responsibility of the landlord; but that same citizen will see the gold emblazoned name "Bank" and with no other information than the sign, and perhaps an acquaintance with some one inside, he will give up the product of his toil and

saving; his hope of comfort and support for future years. We are often met with the stock argument that the private banker should not be subjected to inspection and publicity for the reason that his individual responsibility is behind his institution. It's a grand idea, that, but without legal examination of both bank and personal responsibility how do you know that the latter will be available when you have to realize on it?

At one of the bankers' conventions held last fall, the governor of the state, in speaking of proposed legislation for the supervision of private banks, stated that he was himself a private banker and advised the representatives of banks under legal regulation first to perfect a system of examination before they preached the doctrine to the private banker; that he had read of too many failures just after examination certificates had been furnished, etc., etc. Admitting that he was absolutely right about the necessity for more perfect bank examinations, what did the man mean by the rest of it? Do supervised banks in his state have to try the ice before the commercial lives of the private banks are to be risked upon the frozen pond of commerce? This was in another state, but is there anything sacred about a private banker from Iowa, for instance? Is he anointed by divine right for the purpose of handling trust funds or receiving deposits that he should be allowed to pursue the broad and easy path of unrestricted banking which sometimes leads to a receiver, while the inspected and supervised "banks" are fighting out the details of bank examination through the centuries? If any experimenting is to be done, if problems are to be solved, by all means let us have our esteemed competitors, the private bankers, in school with us. We can study better if we do not have to look out of the window and see them having a good time diving in some financial swimmin' hole or chasing the butterflies and gathering the daisies of uncertain profit without restraint.

While there is plenty of just criticism relative to the sufficiency of bank examinations, both state and national, it can hardly be denied that they accomplish some good. We do not know how many lives are saved, for instance, through boiler inspection, and it is an unwritten chapter how many million dollars have been saved to depositors and stockholders of bank institutions through supervision. We are sure to hear of the inspected boiler or the inspected

bank going up in the air; it's a news-item when the trusted bank president goes wrong through speculation, but it is not very good logic to condemn inspection or trust on account of these exceptions; besides, there is no guess work about the merit in bank examination —the records prove it conclusively. Bank examinations can be made more effective. Nothing will guarantee the honesty of a trusted official, but his time of speculation can be limited and fraud can be made a very difficult and thorny path by perfecting the system.

In the interest of general commercial stability what bank would object to paying three or four times the present cost of examinations to have them made thorough, efficient and sufficient? No better investment could be made, and we shall see the day when the examiner will stay with a bank long enough to be able to give a reliable bill of financial health, and when his field will be so limited that he can obtain accurate information as to the value of the securities listed. It will be a long step in progress when the directors will be required to go over the notes and securities with the examiner. Some of our captains of industry who are directors in a dozen large banks would not have the time to do this, a fact which is positive proof that they should not be figureheads in so many institutions. In the perfection of the business of banking the duty of the director becomes more prominent, and his fulfillment of that duty more and more essential. One of the greatest evils of the system of banking is that directors will accept the responsibility of their important officers and in spite of the requirements of law and business methods, leave a president or a cashier to conduct a "one-man bank," until the officer becomes a moss-back, imbued with the idea that the bank is his personal property, and one who actually resents inquiry instead of being glad to divide the responsibility with those to whom a large share belongs—the board of directors.

Neither can I understand why men of probity and ordinary business sagacity will so far forget the sacred trust reposed in them as directors of banking institutions, will so far neglect their duty to the community, their friends and neighbors, as to permit some bank officer to have such freedom in management as to receive from his lips the wretched confession that the bank's accounts contain false entries; that he has organized a regular system of dishonesty among

subordinates; that hundreds of thousands of dollars have been appropriated under their very eyes; that the funds for which they are responsible legally and morally have been stolen while they were complacently admiring their own names prominently displayed on statement folders.

I have for some time had the idea that we might also go higher up in perfecting the safety appliances of banking. Again using my native state as an example, some one willing to serve as a national bank examiner must be unearthed. I do not hesitate to say that qualifications of experience, knowledge and ability would have no weight whatever against political pull, in the appointment of a national bank examiner in the state of Iowa, and I believe it is the custom of the Comptroller of the Currency to make appointments in every state according to the recommendations of either the senators or the entire congressional delegations. Again, in the vicissitudes of politics, suppose that the wrong man should be appointed at the head of bank supervision. Imagine an incompetent or dangerous financier in the office of Comptroller of the Currency or auditor of state. We have always been fortunate in having a capable government servant in charge of national bank supervision, but it has in at least one instance happened more by a fortunate chance than as the result of thought and deliberation. When one remembers the vast interests under the regulations of that office and the fact that the enforcement of some of the wise provisions of the national bank act is hampered by the want of means and penalties, is it unreasonable to suggest that a commission, chosen for its knowledge of good banking and of high individual integrity, removed from politics and with all the force and dignity of our Supreme Court, with authority to appoint skilled examiners and power to enforce the letter and spirit of the law, would be none too important for the interests under its control? When we want to dig a canal we look for hundred-thousand-dollar competency, and if it is not to be found we get along with several twenty-five thousand dollar engineers; but when it comes to opening and maintaining that most important canal of business confidence, through which flows the credit of the nation, the life-giving stream of commerce, we hand out a title and a prospect of possible political advancement or an ultimate paying job with a city bank.

Some of our banking institutions are getting pretty large, and the great concentration of banking power has brought with it an increasing investment of the people's deposits in speculative securities and a diminishing proportion of investments in legitimate commercial loans. The dangers of our great banks tending toward the promoting finance company rather than the bank of deposit and discount, and the temptations following great financial power to the officers of those institutions, are before us. A commission which would carry all the prestige, weight and importance of our Supreme Court is needed to hold down the great bankers to the strict regulations of law and the requirements of safe commercial banking, for they are in a measure a part of that limited body of men suffering from the "get-big-quick" mania whose power has become so vast that there is a live popular demand for commissions to control them in other walks of trade and commerce.

The public is justified in demanding not only that every institution which accepts deposits under the sacred name of bank—the emblem of confidence and credit—should be under proper legislative control and subject to examination and efficient supervision, but that every bank now under such legal restrictions should be subject to such stringent enforcements of its requirements as will compel it to do a legitimate banking business—not a speculative or "stock washing" business—and to carry out the proper functions of banking. If anything short of the most effective control, examination and supervision possible to enforce were contemplated, far better for those institutions already under supervision to let state and nation keep hands off the private bank now running without legal restrictions. Anything short of wise and thorough regulation would mean the throwing of the cloak of legal sanction around such to the detriment of banks now profiting through the confidence-accorded state, national and properly supervised private banking institutions—where the public happens to think and discriminate.

We have come to a passage in our national career where clear minds, stout hearts and strong hands are required to guide the ship of state between the rocks of socialism and the reef of business autocracy; the very safety of our republican institutions depends upon control of the rudder and the constancy of the brilliant searchlight of publicity. We will come through safely, God grant, but

this is not the time to blink at dangers that threaten; not the time to dismiss them with a flippant word as to government interference, commercial independence and the evils of too many laws.

THE EVOLUTION OF THE BANKING LAW

ADDRESS DELIVERED BY THOMAS B. PATON, EDITOR OF THE "BANKING LAW JOURNAL," BEFORE THE MISSOURI BANKERS' ASSOCIATION IN MAY, 1902.

It has seemed to me that one of the things which might claim some small share of attention is the subject of the laws which govern business dealings; not so much the laws which govern the organization and powers of banking corporations as those laws which govern the instruments of trade in which bankers deal, the bills, notes, checks, and other instruments representing money, and the documentary securities representing property values, which constitute the bone and sinew of the mercantile wealth of the country, and which it is the peculiar office of the banker to deal in and to make effective. It is concerning the laws which govern these instruments of trade, as well as the laws which govern the acts of the banker as the agent of commerce—how these laws have grown up and been developed, their present condition, and how they are applied and enforced in the various states of this great American Union—whether they are entirely satisfactory as they now exist, or whether there is room for improvement—upon which I desire to submit a few remarks.

Now, it is hardly necessary as preliminary to a discussion of the laws to say anything about the importance of the negotiable instrument—the bill, the note, and the check—as an instrument of commerce, and of the part the banker plays to make that instrument effective. Every individual transaction of the vast multitude of daily dealings, whereby goods are sold or services performed, requires the payment of money or some equivalent; and as modern trade transactions are conducted largely on credit, the negotiable instrument, as a substitute for money, is the medium for payment most largely employed. If there were no such thing as a negotiable

instrument, representing the element of time in the making of a payment, and if actual money were the only medium available, the great bulk of trade transactions on credit, which make up our modern commerce, could not be carried on, and even with the negotiable instrument, if there were no such thing as a bank, to stand ready with its cash as a commercial purchaser of the instrument, the same thing would be true. In this view, we see the negotiable instrument and the bank as twin necessities, constituting the two foundational props upon which the modern business of the interchange of property is conducted.

Then, again, in all those large varieties of transactions involving the making of payments where the element of time, or credit, does not enter, but the question is one of using the most convenient or economical medium, we find the negotiable instrument largely employed in preference to actual cash as best suited to the necessities of the case. If money is to be paid to a creditor at a distance, the shipment of actual money is too cumbersome and risky; so this is done by means of a banker's draft, or other instrument of like nature. And without multiplying instances, every depositor in a bank pays his debts by issuing his check on the institution, preferably to cash, as a more convenient and economical method of settling his obligation. The check is the most powerful instrument in the country for economizing the currency, both metallic and paper.

I have made this brief reference to the importance of bills and notes and checks, and of the conduct of modern deposit and discount banking with these instruments, to fix in your mind the necessity that exists for a good, well regulated, uniform, just, and equitable body of laws governing these important matters; and this brings me to my main theme—what are the laws governing these subjects and how did they come to be established?

The formation of our law governing bills, notes, and checks and the dealings of bankers is the result of a peculiar process. The law consists of a body of rules which have been built up piecemeal by judicial decisions founded on custom. It has been developed out of the disputes of men. This process originated in England, from which we derive the original of our laws, and has continued in the various states of this country since the American Revolution. At

occasional times in the process of judicial rule-building there have been statutory enactments providing rules on this or that particular point of commercial law.

The foundation or starting point of this process was the established custom of English merchants with reference to bills of exchange. Six hundred years ago England began to be a trading country, and English merchants would ship goods to various cities on the continent of Europe and would receive shipments of goods in return. To save the sending of actual money back and forth in settlement of these trade debts, the use of bills of exchange came into vogue, and these were first confined to foreign bills between English merchants and foreign traders. The bill of exchange was, at first, not a negotiable instrument in the sense in which the term is now understood, but was merely an instrument by which a trade debt due in one place was transferred to another. Later, these foreign bills of exchange came to be negotiable and to be transferred by endorsement and delivery. At a point of time prior to any decided case announcing a positive rule of law, there had grown up and been developed a settled custom of merchants with regard to the negotiation, the presentment for acceptance and payment, the protest upon dishonor, and the rights of holders of these foreign bills of exchange. The first decided case upon a bill of exchange arose in 1603, about 300 years ago.

Gradually, with the growth of trade and general business, new customs sprang into existence and general recognition. About 250 years ago, inland or domestic bills of exchange between traders in different cities in England came into vogue, and afterwards their use was extended to all persons, whether traders or not. Promissory notes came into use at about the same time as inland bills of exchange. About this period, also, the merchants of London began depositing their cash with goldsmiths, and for these deposits they would receive goldsmiths' notes, or "banker's cash notes," as they were sometimes called, and the goldsmiths would lend out a portion of these deposits at interest. Later, the goldsmiths' notes were supplanted by the bank check, payable to bearer, which became the means of paying the deposits on the order of the depositor; and still later, these checks were drawn payable to the order of named payees.

The customs which thus grew up and were generally recognized with regard to bills, notes, and checks, and the business of banking, have formed the ground-work of the system of judicial rules which have been built up by the courts regulating the subject. From time to time disputes would arise between merchants concerning some particular instrument; the courts would be appealed to; they would take proof of merchants as to what the custom was; and decisions would be rendered recognizing the general customs shown to exist and announcing rules of law in accordance therewith, not only for the government of that particular case, but for the government of all cases of like nature. From the first decided case, in the year 1603, cases came up in the courts with increasing frequency, but the courts would not always decide the same way. In the year 1702, for example, a celebrated dispute arose over the negotiability of a promissory note. At that time inland bills of exchange, as well as foreign, were indisputably negotiable, and the courts, in several previous cases involving promissory notes, held notes negotiable in like manner; but in that year a case came before Sir John Holt, Chief Justice of the Court of King's Bench, who held that a promissory note, payable to one J. S. or order, was not a negotiable instrument within the custom of merchants, and that the contrary idea proceeded from the obstinacy and opinionativeness of Lombard street, which attempted in these matters to give laws to Westminister Hall. But Lord Holt's decision was so contrary to the general understanding, as well as to commercial necessity, that in the following year the English Parliament changed the rule he had established by enacting that promissory notes, payable to any person or order, should be assignable or endorsable over in the same manner as inland bills of exchange, according to the custom of merchants.

Gradually, as the law came to be established in a body of judicial decisions which crystallized into set rules the various customs shown to exist, there came to be less and less resort to custom, for the decision of new cases which arose, and more and more resort to the precedent of earlier decided cases.

Now, this very inadequately describes the process by which the English law has been built up—a process which has been continued in this country since the American Revolution. When the original

thirteen states became independent, and as new states have from time to time been admitted into the Union, the legislatures, in a majority of cases, have enacted a few statutory rules governing bills and notes, regulating the matter of acceptances, the negotiability of notes, and some other matters, and have left to the courts the formation of the great body of rules governing our subject under a process which has taken the English body of decisions for a basis, and has added new rules as new questions have arisen for determination.

Now, what is the condition of the law governing bills, notes, and banking as we find it in this country to-day, as a result of this process of judicial rule-building, with statutory accompaniment? We find that the process has gone on independently in each of the fifty-two states and territories—that each state and territory has its own independent body of law, statutory and judicial, and that on many vital points, with regard to negotiable paper and the banking business, the rules adopted in the different states, both by the legislatures and the courts, are diametrically opposed. Were all transactions in bills and notes, and all banking dealings, confined between parties in the same state or territory, it would not matter so much whether the theories and rules adopted in any particular state were, or were not, the best or nearest correct. Dealers in each state would come to know the law and to adapt their transactions with reference thereto. But in this great country trade and commerce know no state lines. The vast interchange of property between buyer and seller, and the banking transactions in connection therewith, are carried on between Texas and New York, between Iowa and Kansas, and between California and Missouri, with the same freedom as are transactions between Kansas City and St. Louis in the same state of Missouri. The banker in each state has correspondents in and negotiates transactions with bankers and merchants in many other states. The promissory note, made in and governed by the laws of Alabama, is often purchased by the banker in Chicago or New York; and the banker in Kansas City or St. Louis holds among his assets, notes and other negotiable instruments which have come from, and are governed by, the laws of sister states. And so while the country is one commercially, and while the negotiable instrument is largely a national circulating

medium, rather than confined within the borders of any particular state, there is not one, but many systems of laws by which it is governed.

Let us take the promissory note as an illustration. Under the rule of the law merchant—the rule evolved from the process of judicial rule-building which I have described—a note is negotiable, although it does not specify any particular place of payment; just the ordinary form of promissory note—three months after date I promise to pay John Smith or order $500. But in some of the states the legislatures have adopted the theory that, to be a negotiable instrument, a promissory note must be made payable at a bank. In Indiana, for example, the legislature has provided that a note, to be negotiable, must be payable to order of bearer in a bank of that state. In Kentucky, by the peculiar statute of that state, a note to be negotiable must be payable to a person or corporation, must be payable and negotiable at some incorporated bank in the state, and must be endorsed to and discounted by the bank at which payable, or by any other bank in the state. In Alabama not all promissory notes are negotiable, but only those which are payable "at a bank or private banking house or a certain place of payment therein designated." And in your own state of Missouri, while there is no requirement that a promissory note must be made payable at a bank, the legislature has provided that, to be negotiable, it must contain the words "value received," words which are not required by the rule of the law merchant.

These are illustrations of statutory conflict; they show that, instead of one standard of negotiability of a promissory note throughout the country, there are several different standards, and the result of these independent systems of statutory law is especially disastrous to all engaged in interstate commerce, for no man, taking a negotiable instrument governed by the laws of this or that particular state, can reasonably be familiar with all the divergent rules affecting its value in his hands.

But the conflict of law governing negotiable instruments is not confined to the state legislatures alone. Far from it. There is a judicial conflict as well. While there are many, and probably a large majority of fundamental propositions upon which all the courts of the country agree, yet there is a very considerable number

of essential points in the law of commercial paper and of banking, whereon the views of judges in different states and the rules declared as a result of those views are not at all in accord. In fact, the conflict is so extensive and far reaching in its detail that any true picture of existing banking and commercial law must be one wherein diversity, rather than symmetry, is apparently the most prominent characteristic.

As the mind ranges over the vast field of conflicting rules it becomes staggered and confused with the infinity of individual instances, which stand out in the reported cases as silent testimony of the unsuitableness of so many independent systems of state laws to regulate properly the important commercial transactions of the country. Standing face to face with so much conflict, it is a difficult matter, in the short space of time at command, to determine which, out of the almost numberless instances, are the best to select by way of illustration. But at the risk of wearying you with a doleful recital, I will make bold to present a few examples.

It has been a common practice in many western states, in the framing of promissory notes, to add a clause promising to pay reasonable attorney's fees in the event the instrument is not paid at maturity. Now, in some of the states the courts have held that a clause of this nature does not affect the negotiability of the instrument. One of the fundamental requisites of negotiability is that the amount payable must be certain, and these courts have held that such a clause does not make the amount due at maturity of the note uncertain, and that, therefore, the instrument is negotiable. In other states the courts have held that the clause does make the amount payable uncertain and that the instrument is not negotiable. I shall not attempt an enumeration of the states in which this point has been ruled one way or the other, but it may be of interest to state briefly what has been held in Kansas and in Missouri on this point.

In Kansas the courts have held such notes negotiable. But in the year 1876 I find the Kansas Legislature passed a law making it unlawful thereafter to contract for payment of attorney's fees in any note or bill, and provided that such a contract should be void. But since that law the Supreme Court of Kansas has held that while it renders nugatory and unenforceable a stipulation to pay

attorney's fees, the law does not vitiate the contract for the payment of money; that such a provision is to be regarded as mere surplusage and the negotiability of the note is not affected thereby. Probably since the law of 1876 attorney fee notes in Kansas are not so frequently used as formerly, yet they are occasionally to be met with and they are negotiable in that state.

Now, here in Missouri, the courts have held just the contrary, and it has become settled by numerous Missouri decisions that the insertion of such a clause in a note makes the amount payable uncertain and renders it non-negotiable. Hence if a Kansas stock dealer should come into Missouri and sell his stock and take in payment a note providing for payment of attorney's fees, delivered to him here in Missouri, and should then take this note back and discount it with a Kansas bank, the note, being governed by the law of Missouri, would be non-negotiable and the Kansas bank would hold it subject to any equities between maker and payee. The same thing would be true of a note which did not provide for the payment of attorney's fees, but which failed to contain the words "value received," as these words, I have shown, are necessary to the negotiability of Missouri notes.

While this condition of non-uniformity of state laws upon the negotiability of notes exists, how important is it that the banker in one state should know the laws of all those other states whose paper he acquired.

Another example: Among the variety of instruments which originate in modern commercial transactions are promissory notes and bills of exchange containing a clause after the promise or direction to pay: "With current exchange on New York," or "with current exchange on Chicago." Notes and bills so payable circulate between traders in different states and often find entry through the discount windows of commercial banks. The consensus of opinion among bankers and merchants is that such paper is negotiable; but here again the courts in different states are ranged on both sides of the fence. In a case which came before the Missouri Court of Appeals, a few years ago, a bill of exchange had been drawn at St. Louis "with exchange on New York." It was decided that the instrument was not negotiable because the rate of exchange constantly fluctuates, and it therefore lacked certainty as

to amount. The court said that if a change of rule was required in the interests of commerce, it should be made by the legislature and not by the courts. On the other hand, in a case quite recently decided by the Supreme Court of Minnesota, where promissory notes had been drawn payable at St. Paul, "with current exchange on New York City," the court held that the provision for exchange did not make the amount uncertain, as it could be readily ascertained. In this case the court said that it was the general understanding of bankers and business men that such paper was negotiable, and that the policy of the courts should be to make their decisions conform, as far as possible, to the general customs of business. The conflict of view on this point has extended into several states and the courts are about equally divided in opinion.

Another instance of conflict is where a bill of exchange or promissory note is made payable in current funds, and the question has arisen whether current funds are the equivalent of money so as to answer the requirement that a note to be negotiable must be payable in money. Decisions have been rendered in five or six states that "current funds" are not the equivalent of money, and that instruments containing such provisions are not negotiable. Four or five other states, as well as the Supreme Court of the United States, have held, to the contrary, that current funds are money and that such instruments are negotiable. This, then, is another instance where a banker in a state where such instruments are regarded as negotiable, who may purchase a note or bill governed by the law of a state which declares them non-negotiable, may be misled by the law of his own state and fall into a trap. I have not by any means exhausted the subject of special clauses in notes which have been interpreted as destroying, or as not affecting, the negotiability of the instrument; but I will not go deeper into this particular.

Another point of conflict which has been most far-reaching is upon the matter of credit enforcements. It is a very frequent transaction for a man to go to a bank and ask a loan of money on his note, which the bank is willing to make, provided he will get some responsible third party to endorse the note, so as to make it double-name paper. Often such notes will be drawn by the borrower, made payable to the bank, and the party signing to give

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the maker credit will endorse his name upon the back before delivery to the payee. Now, there has been a very wide conflict of decision among the courts of the country as to the character of liability assumed by such third party. In some states he has been held a joint maker, in others a surety, in others an endorser, in others a guarantor; each of these contracts being of a different character and imposing different duties upon the holder of the note. I cannot attempt any enumeration of the rules in different states on this subject—nearly every state in the Union has decided it one way or another—but I will simply state the rules which have been adopted in the courts of Kansas and in Missouri. In Kansas, when a man writes his name on the back of a note before delivery to the payee, he is prima facie a guarantor; but parole proof may be introduced to show a different understanding or agreement as to the character of liability. In Missouri, such a man is presumed to be a joint maker, but the actual contract can be shown by outside evidence. There is one case reported in Missouri where outside evidence was admitted to show that the third party, in reality, contracted as endorser, and in this case he was discharged from liability, as the holder of the note had not complied with the law with regard to due demand and notice of dishonor.

I come now to one other important matter upon which there has been wide conflict among the courts all over the country—the matter of sufficiency of consideration to constitute one who acquires a note a bona fide purchaser for value, so as to enforce it free from equities. A gives his note to order of B, being induced to do so through fraud of B. B owes his banker a sum of money and the bank is pressing B for payment. B says, "I cannot pay you the money, but I hold A's note to my order, not yet due, and I will endorse this note over to you as security." This is done. Now, the important question arises. The bank not having given actual money for the note, but having only received it for an antecedent debt, is it to be regarded as a purchaser for value so as to enforce the note against the maker, free from his defense of fraud? In nearly every state in the Union this question has been passed upon by the courts, and the two opposing theories have been adopted—one that a pre-existing debt constitutes the bank a holder for value, the other that it does not.

In Missouri, where a negotiable note is transferred to a bank merely as collateral security for a pre-existing debt, no new consideration being given for it, the bank takes it subject to all the equities existing between the original parties. But a Missouri bank which accepts a negotiable note before maturity in payment of, as distinguished from security for, a pre-existing debt, is regarded as an innocent purchaser for value; and this bank is also given the same rights as an innocent purchaser even where it takes it as security if at the time it makes an express agreement to forbear suit on the debt until the collateral shall mature.

What is the law in Kansas? In Kansas it has been held that he who received the note of a third party in payment of a pre-existing debt parts with value and is entitled to the protection of a purchaser for value. This is the same as Missouri, but I do not find that the question of the rights of one who takes such a note from the payee as security, and not in payment of a pre-existing debt, has been decided by the courts of that state.

I will not go any further into the matter of conflict of state laws governing bills and notes. Enough has been said to illustrate the proposition that wide conflict exists and that the present condition of law, made up so largely of independent and antagonistic state rules, is far from satisfactory, hampers commercial transactions, and causes great losses to the mercantile and banking community. Not only does this conflict with reference to bills and notes, but it is apparent all along the line of banking law. It extends to checks on banks, to certificates of deposit, to bills of lading, to warehouse receipts and other classes of documentary security taken by banks as security for advances; and it runs into the operations of banks as agents for the collection of commercial paper, checks, certificates of deposit, bills of lading, and the liability of collecting banks.

But I must not leave the subject of the present condition of the law governing banking and bills and notes with an expression of the idea that it is all as bad as it can possibly be and there is no good in it. I have been simply pointing out the condition of conflict. To the contrary, great as its bulk has grown to be, and scattered as it is in some twenty thousand decided cases, reported in hundreds of volumes of reports, the subject governed is most

intricate and complex, and the law works out the rule of right and substantial justice in the large majority of individual instances. The rules of law have been built up in the exercise of judicial reasoning, applied to particular transactions with painstaking and conscientious effort. They are the product of the accumulated wisdom and experience of ages, and no one man or set of men, in any one generation, could produce anything so beneficial and effective. While error and bad judgment, and, in some instances, a too slavish following of precedent, contrary to sound reason, are evidenced, this is only in individual cases, and is not characteristic of the whole body of the law. The numerous instances of conflict are a blemish, rather than a vital defect. Further, in aid of its accessibility, learned men have arranged its rules in scientific order, sub-divided the various propositions in chapters and sections, and have published the results of their labors in text-books on banking and on bills and notes, in which the decided cases are cited in foot-notes as authority for the rules announced. These books, while unofficial, are of the greatest use, not only to the lawyer, but to the banker and the merchant, in showing him what the law is upon any particular point.

The great difficulty is to be found in our political conditions. Commercially, the nation is one, but we have not one, but fifty independent fountain heads of law, governing commercial transactions; and a conflict of rule is inevitable so long as men are constituted to think differently upon the same state of facts. It is in these matters of conflict of law, statutory and judicial, governing commercial transactions, that there is need for improvement.

And the improvement is on the way. All of you, doubtless, are familiar with the negotiable instruments law, which has been so successfully advocated by the American Banking Association, and which has up to date been enacted in seventeen states and territories, besides the District of Columbia—more than one-third of the whole. This law covers bills, notes, checks, and all negotiable instruments, and it affords the needed improvement in the laws governing these subjects. While the negotiable instruments law is the independent statutory enactment of each state where enacted, still, its rules being the same in all, it provides the needed uniformity. Instead of many standards of negotiability of a bill or

note, there is one uniform standard, and the banker purchasing paper coming from any state where that law prevails can know what he is acquiring. It provides not only a uniform standard of negotiability, but also one rule governing the matter of consideration, the liabilities of endorsers, the rights of holders, and with regard to presentment for payment and proceedings upon dishonor. For this law, commercial America should be truly thankful, and when it comes to be enacted in all the states, as it would seem reasonably destined to be, the improvement wrought by way of simplicity and uniformity will be vast, indeed. Of course, the negotiable instruments law does not cover all the matters of conflict in which improvement is desired. It does not regulate certificates of stock, bills of lading, and securities of like nature which are dealt in by bankers; it applies to negotiable instruments payable in money only. The unification of the laws upon these matters must be hoped for in the course of time, when all the state legislatures act in uniform accord, and when all the judges come to think alike.

And now this completes my brief and necessarily imperfect description of the evolution of banking law. The subject may be likened to a tree, three hundred years old, with roots planted in England, whose fifty branches have grown throughout the states of this great American commonwealth. A tree which has brought forth both good and evil fruit—a tree whose twigs have expanded and multiplied in a variety of ways, and in many instances have been twisted and tangled and have crossed one another, impeding, to some extent, the symmetrical growth of the whole. A tree which requires constant care and nourishment by intelligent gardeners, drawing their knowledge from the same fountain of judicial wisdom; a tree which calls for occasional pruning of its dead material by the legislative pruning knife; but a tree which, with the onward march of ages, with increasing education and enlightenment, with the nearer and nearer approach of man to God, is destined to grow and expand to a perfect tree of justice and of right.

FINANCIAL ADVERTISING

ADDRESS DELIVERED BY WILLIAM S. POWER, PRESIDENT OF THE WILLIAM S. POWER COMPANY, PITTSBURG, PA., BEFORE THE PENNSYLVANIA BANKERS' ASSOCIATION, AT ATLANTIC CITY, OCTOBER, 1904.

IT would be a useless waste of time for me to attempt to argue the value of advertising in general. It is a fact too well established to admit of argument. Publicity is the basis of all business success—the corner-stone without which all other things are useless. And publicity is advertising.

It may take any one of a dozen different forms. It may consist merely of a sign above the door, or of a name in the window; but it has got to be there in some shape or form, or there can be no business success. It is an easily understood axiom that there must be knowledge of a business on the part of the public, or there can be no business. Hence the question resolves itself into one of method rather than of expediency.

How can we advertise a financial institution so as to achieve the largest results on the smallest expenditure of money? The essential question is not, How much do you spend for advertising? but, How much do you get out of it? You buy investment bonds, not because they are beautifully engraved, on heavy paper, with a picture of George Washington or the American eagle in the center, but because they pay a good rate of interest and have a substantial value back of them; and you must use just the same hard common-sense in the expenditure of your advertising appropriation. I have known bankers who were as proud as a peacock of their advertising, because it displayed their names and their large resources in prominent type, and who seemed utterly unmindful that they got no tangible results from it.

Now as to methods. There are a dozen or more different lines upon which an advertising campaign may be based. All are good in their way, and it is not so much a question as to which method you select as it is of the persistence and intelligence with which you carry it out. When a man comes to you and tells you that, if you want to advertise successfully, you must do it by one particular method which he has evolved, put him down in your mental notebook either as an ass or as an insufferable egotist. There is not any one sure way.

Now, broadly speaking, we think of advertising as divided into two classes—general advertising and direct advertising. The first class reaches the masses through the medium of the newspaper and other publications, while the second class reaches the individual through the medium of personal letters, folders, booklets, and so forth, sent directly through the mails.

Under ordinary conditions, newspaper advertising must take first rank. The newspaper is the universal messenger to the hearts and homes of the people, and intelligently used newspaper advertising is just as certain to bring results as good stocks are to pay dividends. Note the fact that I said "intelligently used." Enough money is wasted every year in unintelligent advertising to make everyone in this hall moderately wealthy. But the same is true of banking as a business, or of farming, or of anything else in which men engage. The trouble is not with these things in themselves, but with the way in which they are attempted. Advertising itself is not a failure, but a great many people make a failure of it.

I know one bank, for instance, that publishes a big, glaring advertisement every time it issues a statement, and drops completely out of sight between times. It is wasting its money. Another bank pays for three inches space every day and crowds it full of officers' and directors' names, never changing it unless a death or resignation makes a change necessary. It is also wasting a good deal of money that might be put to work in a better cause. One bank in western Pennsylvania was advertising a savings account pass-book as a desirable Christmas gift in the middle of July, and still another one is at this minute advertising the joy of having a savings account on which to draw now that the time has come for a summer vacation. Glaring examples of how not to do it; and yet the bankers who are paying for all this misdirected publicity are shrewd, conservative men who have made signal successes in life along other lines. The trouble with them is that they look upon advertising as an expense that must be tolerated rather than as an investment that may be made to pay large returns.

If I were asked to lay down a rule for effective advertising, I should say: Take a liberal supply of simple, honest facts and mix them with an equal portion of ordinary common-sense. You must study the people to whom you want to talk, and you must talk to

them in a way that will interest and appeal to them. You must tell them the things they want to know about your bank—not all at once, but one point at a time; remembering always that the one essential point is to reach just as many people as possible, and to interest them in your particular bank.

Above all, advertising to be effective must be persistent. A common mistake is to look for results too soon. When a farmer plants his wheat in the fall, he does not expect a harvest in a week or a month; when you give an order for a ten-story office building, you do not go around to the site the following day and expect to find a completed building. The farmer knows he must wait until the seasons and the chemicals of the earth work their changes; and you know that your building must proceed by gradual stages—brick upon brick, until finally finished. So it is with advertising. The first insertion does not influence the public mind, nor the last. But one added to the other, everyone gathering strength from those that precede it, gradually influence the public mind and bring to your bank the business you desire.

Public opinion moves slowly, but it moves with irresistible force. It may require some time to steer it into your channels, but by persistent advertising you can control it; and once under control it gathers force as a snowball rolling down the mountain side gathers snow.

A very interesting experiment was made a short time ago in one of our great rolling-mills. A bar of steel weighing half a ton was suspended vertically by a slender chain. Near by a cork from a bottle was suspended by a silk thread. The cork was started to swinging so that it struck gently against the steel bar. Of course, it made not the slightest impression. But the motion of the cork was continued, and at regular intervals it struck the great bar of steel in exactly the same place. Five minutes passed and still no effect was noted on the bar. After ten minutes, however, the bar gave evidence of feeling uncomfortable. A sort of nervous chill crept over it. At the end of twenty minutes the chill gave way to distinct vibrations, and fifteen minutes later the great bar was swinging like the pendulum of a clock. A single week or month of advertising is merely a blow or two of the cork against the bar of steel. Its effect is absolutely nothing. It is money and effort

wasted—but the continuous, persistent hammering, week after week, month after month, is just as sure to start the pendulum of business swinging your way as day is to follow night.

And this persistency must manifest itself in every feature of your advertising. If you use newspapers or periodicals, you must use them regularly, and the advertisements must be changed at least every second or third insertion, in order that they may appeal to the reason of the reader as well as attract his attention. If you use the mails in direct advertising, you must use them continuously, sending out something every two or three weeks—or at least every month. My own idea is that the newspapers and the mails should be used conjointly, the one following up and supplementing the other.

Now, just a word as to printed matter. This is an essential feature of modern advertising, and the one thing to remember in regard to it is that to be effective it must be of high quality. In direct advertising postage is always a large end of the expense, and as it costs just as much to send out a cheap, poorly printed booklet or folder as it does one that is artistic and handsome in its get-up, it becomes apparent, even without the use of a powerful microscope, that the saving of a few dollars in the printing bill at the expense of effectiveness is mighty poor economy. If you are going to issue a circular or a booklet—or even a little statement folder—be sure that it is good enough to represent your bank. Many a good and worthy institution is very sadly misrepresented by its printed matter. It is a good thing to remember always that, when you send out an advertisement, either through the newspapers or through the mails, you are sending a personal representative to carry the story of your bank to the people with whom you hope to do business. And it is just as essential that your printed matter be neat and attractive in appearance as it is that you yourself should have on a collar and a decent suit of clothes during business hours. First impressions are lasting, and when you are after business it is absolutely essential that the impression you make on prospective customers by your advertising should be of a character to attract rather than repel them.

Another thing: Bank advertising above all else must be dignified. It never pays to try to be funny or frivolous in an adver-

tisement that is going out broadcast to all sorts of people. Fully three-fourths of them will misunderstand it, and the other fourth will lower their mental rating of you several pegs. It is amazing how easy it is to get ourselves misunderstood, and how often our reputations are damaged by a carelessly uttered word.

It has often been said that advertising is something that you have to take on trust. Advertisers say that it pays. People generally believe that it is profitable, but how are you going to prove it? Savings banks, of course, especially those doing a banking-by-mail business, can trace definite results; but how can it be proven that national banks and trust companies reap any real benefit from the money they spend in advertising?

The president of one of the big trust companies in Chicago recently said: "Advertising is all bosh. I don't believe we get any tangible returns at all from the money we spend in that way. I figure that it costs us just that much to stand in with the newspapers." Now there is a man who has made a success of his banking business—a capable business man, a shrewd financier; yet a man who could talk the most absurd nonsense when he attempted to discuss a feature of his business that he had never taken the trouble to study sufficiently to become familiar with. If one of his clerks had wasted a dime in an ill-advised investment in steel pens or lead pencils, he would have called him down for it. Yet he was himself spending several thousands of dollars a year for something that he declared was absolutely worthless. Queer notions people have on this subject of advertising.

But does advertising pay? Can we prove it? I have been asked that question so often by bankers and others that it has occurred to me that about the best thing I can do at this convention is to attempt to answer it. As a matter of fact, it is one of the easiest of advertising problems to solve. Banks and trust companies are compelled by law to issue statements showing their actual standing from time to time. These statements tell the whole story, and tell it truly. You can read it for yourself in your own city or town, if you care to take the trouble. If, over a given period of time, the banks that are persistent advertisers grow two or three or four times faster than the banks that do not advertise, it is at least fair to conclude that advertising pays—is it not?

Take the city of Pittsburg, for instance. More money is expended in legitimate bank and trust company advertising in Pittsburg than in any other city in the country; hence no better place could be selected for the making of comparative figures. There are a great many banks in Pittsburg. About half of them are known the country over because of their liberal advertising. The other half do not believe in advertising, on the general plea that they can use their money to better advantage. Possibly they can, but figures are against them. I have gone back over the statements of the last five years, comparing the growth of the banks that have advertised continuously with that of the banks that have advertised only now and then, or not at all; and this is what I find: During the five years the banks that have advertised continuously have increased 38 per cent. in assets and 85 per cent. in deposits. The banks that have not advertised have increased 27 per cent. in assets and 11 per cent. in deposits. This record is affected necessarily by the numerous combinations of recent years, but these have been eliminated so far as possible, and the figures given err on the side of conservatism rather than otherwise.

But come down to the last year, the year that has tried men's souls, and that has caused banking institutions as many bad half-hours as any year in the last quarter of a century. In times like these the cumulative force of advertising ought to make itself felt, if it ever does, and hence a comparative record of the past year is even more of a test than the record of five years. The record of a single year is also much more accurate, as it is possible to include a much larger percentage of the banks without running against combinations that swell the figures abnormally. And here is the story the year has told: In assets the advertising banks have gained 21 per cent.; the non-advertisers have lost 5 per cent. In capital the advertisers have gained 15 per cent.; the non-advertisers have lost 11 per cent. In surplus the advertisers have gained 16 per cent.; the non-advertisers have gained 10 per cent. In deposits the advertisers have gained 22 per cent.; the non-advertisers have lost 7 per cent. In other words, the banks that have been persistent advertisers have shown substantial gains in every essential feature. The banks that have not advertised have lost in everything but surplus, and the gain there is not nearly so great as in the other

class. It is interesting to note, in looking over the records, that only one bank in the advertising class shows any loss, and that was caused by the withdrawal of a constituent institution; while among the banks that have not advertised there are only three or four that do not show a loss in both deposits and assets.

Is there any indication in all these figures as to the value of intelligent advertising? Do they answer the question as to whether or not we can prove that advertising pays? Why, if it were possible to present the same proof to the average manufacturer or merchant, he would double his advertising appropriation without a moment's hesitation. It is the most absolutely convincing proof of the tangible value of intelligently used printers' ink that has ever been presented, and I am glad to be able to bring it to you just at this time, when so many people are inclined to cut down their advertising until financial conditions improve. The very time when advertising counts for most, when it is most valuable to you, is when business conditions are adverse. In times of prosperity business comes easy and everybody feels the benefit. In times of depression it is the bank that has become firmly intrenched in the hearts of the public that continues to grow in strength and volume of business.

There is a very important feature that lies back of success in all advertising campaigns, and that is the personal equation. In other words, the bank itself has got to make good. You can talk about your strength and your courteous treatment of customers until you are black in the face, but if you have not got the strength, and if you are not actually courteous and obliging in your business dealings, you will not get any permanent good out of your advertising. Advertising will draw people to your bank, but it will not make them permanent customers. It is the man who dominates the policy of the bank who counts in the permanent upbuilding of the institution, and all the advertising in the world will not bring satisfactory results if the man himself does not make good.

BANK ADVERTISING

ADDRESS DELIVERED BY FRANCIS R. MORISON, AUDITOR AND ADVERTISING MANAGER OF THE CITIZENS' SAVINGS AND TRUST COMPANY, OF CLEVELAND, OHIO, BEFORE THE BANKERS' ADVERTISING CLUB OF PITTSBURG, PA.

THE last few years have brought many changes in the methods employed by banks and trust companies in extending the business of their institutions. The very fact that you gentlemen have considered it advisable to organize the "Bankers' Ad Club" of Pittsburg is in itself an evidence that you realize and appreciate the benefits to be derived from dignified, yet progressive, publicity. It is certainly one of the highest tributes to advertising, that men engaged so actively in the many problems of finance deem it of sufficient importance to meet at stated periods in order to discuss the principles involved in the expenditure of advertising appropriations, and I am sure that the effect of such discussions will exercise a stimulating influence on bank advertising, not only in this city, but throughout the country at large.

Advertising is a feature of the banking business which is perhaps the least understood, and yet it is becoming more and more an essential factor. It seems pertinent to treat this subject at some length because of the presence at this meeting of a large number of bankers, every one of whom is intent upon increasing his business. Bankers, as a class, realize the necessity of publicity, but the question which troubles them is how to advertise in order to obtain the largest returns for the smallest expenditure.

And now a few words as to this expenditure of appropriations. It recently became known that the chief executive officer of a large trust company in the East investigated personally the items expended for publicity by his company. He found that the appropriation had been placed in the hands of an advertising agency, which had used a large number of publications practically possessing no advertising value whatever. This particular instance is cited with a view to calling the attention of officers of banks and trust companies generally to the importance of seeing that the large appropriations set aside for advertising are spent judiciously, and to warn them against the profligate waste of money entailed by the promiscuous placing of advertisements in newspapers and journals without regard to their circulation and clientage.

In the case of small institutions, one of the officers should systematically devote a portion of his time to the direction of the advertising, as the subject really requires the attention of one man to maintain fixed policies which local conditions and environment make advisable.

In the case of larger banks and trust companies a regular advertising department should be organized and placed in charge of an officer of the institution. I am sure that many of you have in mind, when I speak of the officer in charge of the bank's advertising, merely a man who sits down and writes newspaper advertisements, booklets, and other literature. Let me impress upon you, however, that the writing is only a small part of the duties devolving on such an officer. He must learn and become conversant with the circulation of the different newspapers, and he must become acquainted with the classes of people which they reach. This knowledge can be secured by intimate acquaintance with the conductors of newspapers of high standing, and advertising managers of magazines and other publications. He must become familiar with the many propositions which are submitted to him, such as street-car advertising, programs, catalogues; and be able to discriminate between the mediums which bring business to his institution and those in which advertising would be absolutely a waste of money. He must have at least a smattering knowledge pertaining to the mechanical part of advertising, such as the lay-out of copy, preparation of dummies, the different styles of type, the comparative merits of electrotypes, zinc etchings, half-tones, and other methods of illustrating. His knowledge in these directions, combined with his general familiarity with financial subjects, will then enable him to obtain results commensurate with the time, attention, and money expended.

There are many psychological principles involved in advertising, and it is most important that every student of advertising should know something concerning the modern discoveries of this science. There are many ways in which we make an impression upon the mind of the prospective client—one through the intellect, another through the emotions, and finally through the will. It is readily seen, therefore, that the connection between psychology and advertising might be summed up in one word, "persuasion," the steps to

which are: attracting attention, inspiring interest, and creating desire. Once we arrive at this last stage, we have succeeded in our advertising effort by securing the surrender of the human will.

When the advertising manager has acquired and mastered all these fundamental principles, he is ready to do successfully the practical work of preparing advertising matter for his institution. When we speak of advertising matter, it must be understood that we include all of the matter used in extending the interests of the institution. There are a number of ways in which any bank comes into possession of a list of prospects. It makes no difference *how* the manager secures his lists; the field must be carefully cultivated and no stone left unturned in the way of securing a hearing. He should install a follow-up system which must be carefully mapped out to meet the individual requirements of his institution. All letters sent out must be well written and to the point, one communication following the other with consecutiveness and consistency. There must be real system. He must be thoroughly informed concerning the new accounts opened as a result of these efforts, for nothing will show weakness and lack of business thoroughness more quickly than to continue sending soliciting letters to the person who has already opened an account, urging him to further the claims of the advertiser.

It is frequently argued by bankers, when discussing advertising, that it is the poverty of subjects to which is due very largely the stereotyped advertising which is done by nine-tenths of the banks in the United States. This advertising, as is well known to you, generally consists of merely the titles of officers, capital, and perhaps a few ambiguous phrases concerning accommodations, and the assurance that the bank works along conservative lines. I acknowledge that the number of subjects is somewhat limited, but nevertheless I assert most positively that they admit of endless variations, and that the themes we possess have by no means been exhausted.

Business-getting qualities are imparted to financial advertising chiefly through the channel of literary composition. By reason of the ultra-conservative nature of bank and trust company methods, the art of producing effective advertising literature is difficult. Its requirements are most exacting. It imposes the most severe test

upon the writer. It matters not how little advertising may be done; it is essential that whatever *is* done be done well; otherwise the matter is not read, and the expenditure is wasted.

The greatest care should be exercised to make the advertising at all times dignified. In fact, nothing could be more prejudicial to the progress of a financial institution than an undignified bid for business. Sensational illustrated cuts in the newspapers, for instance, always suggest to my mind a man wearing a dress suit embellished with a red necktie and tan shoes.

It is impossible to determine the exact value of the various advertising media. But after fourteen years of experience in bank advertising, I am emphatic in stating that a large part of my appropriation belongs rightly to the daily newspapers and other generally acknowledged publications.

An important point, however, in newspaper advertising is that it must be consecutive, consistent, and continuous to produce the best results. It is better to take three inches fifty times than to take one hundred and fifty inches once. It is the steady dropping of water that wears away the rock, and it is the constant advertising on the part of a bank or trust company which impresses the people with the idea that it is the one financial institution with which to do business. Placing one advertisement in a paper to see how it will turn out is the rock on which is wrecked many a bark of advertising enterprise. The results are almost invariably similar to the Indian who was told how soft it was to sleep on a feather bed. He arose after a comfortless night, when he had placed one lonesome hen's feather between his shivering body and the naked rock, and remarked: "Humph! white man's feather bed heap dam fraud."

Advertising by means of booklets and printed matter is receiving a large share of attention. The success of booklets depends more upon the way arguments are presented than upon the grammatical construction. Long sentences and ambiguous phraseology are of less service than simple, direct talk which can be understood equally by the ignorant classes and the wealthy or the well educated. The profoundest students of literature agree that the King James version of the Bible is the purest English in existence, and yet it is understood by millions of ignorant people on both sides of the ocean.

Simplicity is appreciated by everybody, because it is understood by everybody.

It is not necessary that these small booklets or folders should be extravagantly gotten up, but in all cases artistic printing and good paper should be utilized. The mission of booklets is to educate the people by forceful arguments, as to the numerous ways in which the bank or trust company can be of service to them.

Banking by mail, as practiced by the banks in Pittsburg and Cleveland, has become somewhat a "thorn in the flesh" to a great many bankers throughout the country, because they feel that this banking by mail is encroaching upon their domains. I wish, however, to emphasize another side of the question, which is to the effect that this advertising carried on by the banks of Pittsburg and Cleveland is in reality a decided benefit to the local bank. The advertising banks place their announcements extensively in the current magazines and agricultural journals, whose circulations aggregate many millions of readers, and a careful perusal of these advertisements will show that the majority of them are written with a view to educating the masses to appreciate the benefits derived by those who cultivate the habit of saving money. The amount of good accomplished by this education will never be fully known, but it undoubtedly is the means of creating a large number of new accounts. And while many of these new accounts reach the banking-by-mail institutions, in my judgment a far larger proportion of this new business is given to the advertising bank *at home* which acts as a stimulus for local business.

During the year 1903, at which time I was an officer of a trust company in an eastern city, I made a thorough investigation into the effect of an advertising campaign which was being conducted in that city by one of the banking-by-mail banks, through direct circularization, and watched very closely the withdrawals from our institution. I found at the end of three months that the withdrawals and closed accounts were no greater than they had been in the corresponding periods of the preceding year, and I learned, on the other hand, that the small accounts opened during that time largely exceeded those opened during the same period of the previous year.

Another point which is worthy of consideration in this connec-

tion is to the effect that, whereas the volume of business obtained by the Pittsburg and Cleveland banks is extensive by reason of the enormous territory covered, yet the business from each locality is too small to affect in any appreciable way the deposits of the local banks, and I am firmly convinced that the loss of a few accounts by any bank because of the larger rate of interest and other inducements offered by the banking-by-mail institutions is largely overbalanced by the new accounts which are the actual result of the work done by these banks along educational lines.

I desire, however, particularly to emphasize the advantage of banking by mail for the outside bankers themselves. A large number of banks in all sections of the country are beginning a vigorous campaign for the business of the rural population in their own immediate vicinities. Ready money is needed by the farmers only at certain periods created by the seasons. This leads to the sequestration of a vast amount of capital in secret hiding-places of countless farm-houses, where it is lying idle and of no use to anyone. Funds of this character, although they appear insignificant, make a grand total which is well worth going after by any bank. Only 28 per cent. of the inhabitants of the United States live in cities or towns where there are savings banks, while 72 per cent. live where there are no such facilities. Out of the twenty-nine million people who are earning a living in one way or another, over two million are engaged in agricultural pursuits, the majority of whom live on farms or in small villages; and while it is true that some of this number are not earning as much as residents of larger cities, yet as a class they are thrifty and saving, and, moreover, their expenses of living are less than those of their metropolitan brethren.

In order properly to invest the income of the farmer during 1905, which exceeded the year 1904 by $256,000,000, 1,754 new banks have been established. There has been a general cancellation of mortgages, and many of the farmers are *loaning* their money, whereas only a few years ago they were *borrowing*. In the education of these people as to the advantages of the banks in the near-by cities (regardless of the rates of interest which are paid), and the fact that it is no longer necessary to pay a visit in person to the bank, lies, in my judgment, the solution of the banking-by-mail proposition.

PART II.

BANKING REFORM AND CURRENCY SECTION

INSURING THE DEPOSITS IN NATIONAL BANKS

BY JOHN SCHUETTE, PRESIDENT OF THE MANITOWOC SAVINGS BANK, MANITOWAC, WIS.

I HAVE been asked at various times to draft a bill that should embody an idea of a suitable plan for insuring depositors in national banks, and to explain certain features showing how such a plan could be accomplished. I have accordingly drafted such a bill, and prepared the following argument, which will give all a better opportunity to acquaint themselves with the plan, and will enable those more directly interested to determine how such a measure would affect their own interests. I am no attorney, and do not presume to believe that the act I here offer is perfect. I think, however, that it is sufficiently clear to convey its intent.

"We have the safest currency on earth. Now let us make our deposits as safe, and then our banking system will be unexcelled."

Through the law of averages, every interest can be insured against loss, and nearly every interest is insured. The first step was insurance against loss by fire. It proved so successful that insurance was extended to many other lines—against loss to ships, cargoes, etc., by the elements of nature; against loss by accidents or death; against loss by failure of a creditor; against burglary of banks, and loss from dishonesty of employees. We can, indeed, insure ourselves against almost any kind of a loss except that of our most valuable asset, our savings or surplus money. Whether we keep our money in our pockets, or hoard it at home, or deposit it in banks, we are liable to lose it. The constant fear for its safety hangs like a pall over nearly every one of us, and when bank failures are frequent, this fear breaks out into a panic which seizes the whole population and carries ruin in its track.

It seems impracticable to insure the money of each individual in his pocket, in his house, or in his bank. The only practical and safe way is to deposit all surplus money in banks, and then let the banks insure all such deposits in total. This can be done in two

ways. Insurance corporations may be organized to insure bank deposits. This, however, could be done only at great cost, and even then it would not inspire the depositors with that confidence so essential in removing all panicky fear. The second plan, and the only one which deserves consideration, as it is the most convenient, the safest, and the cheapest, is that of a bankers' mutual insurance plan under government control. The government might establish such a plan with the stroke of a pen, to speak in common parlance, and with but little extra expense; while corporations would have to spend millions to get the business, and they would require many years to get it all.

There seems to me to be but little doubt that, unless a mutual plan is adopted, insurance corporations will be organized in the near future to insure the deposits in bank, and practically every bank will be forced to take insurance of this kind, though under what disadvantageous conditions! The cost would be double that under the plan I am about to propose, and the depositors would not have the same feeling of confidence by any means that they would have if the insurance were under the control of the government.

It may be argued that the insurance of deposits should not be compulsory, but voluntary. Freedom in this respect may be permitted, and the banks that are insured might be designated as secured national banks. But would not competing banks in the same locality be compelled to insure its depositors, till finally all would have to come into the mutual plan, whether it were optional or compulsory?

The chief objection to this insurance is that at first, and perhaps for some time, the number of banks to join in the mutual system might not be sufficient to insure unquestionable success. The main element of safety in any insurance lies in the large number of risks, spread over a large territory, within the shortest possible time. Thus the desired general average is secured. Such an average would be immediately secured under the compulsory insurance plan, since it would embrace at once every bank; and the prospect of success from the beginning would be much brighter.

The direct benefits derived from the mutual plan would be, first, that a bank would be secure against loss of deposits in its reserve or in any other bank; second, that deposits would be largely augmented

when it was known that they were perfectly safe; third, that a smaller cash reserve would be necessary. This point is well illustrated in a circular by Horace Lloyd, cashier of the National Bank of Phoenixville, Pa., in which he says:

And now I will show that the depositors themselves would be indirectly the ones to establish the insurance fund. Take for example $100,000 of deposits. Most banks (those outside of the redemption cities) are now required to keep a reserve of 15 per cent. of their deposits, which would be $15,000. I propose to reduce this to 13 per cent., $13,000, thus releasing, $2,000; which sum, invested at 5 per cent., would yield per annum $100, which is just the amount of the insurance tax. Could anything be simpler? In fact, a reserve of even 13 per cent. would not be necessary, as such a thing as a run on a bank would be unknown. All the reserve a bank would need would be sufficient funds to do business.

If anyone can devise a plan better or simpler, I hope he will do so; but I think the day is not far distant when something will be done along this line.

The ever-existing dread of bank runs and stringency in the money market would almost wholly disappear. What a relief this would be to the banker! The much-discussed flexible currency would not require our attention any more, because a money stringency can be brought about only by a loss of confidence in banks whose depositors are panic-stricken and draw their deposits out of banks to put in safety boxes or to hoard it at home.

This is explained by Comptroller J. H. Eckels in his report of 1893, on page 5, in which he shows that in that year, from May to September, 378 million dollars of deposits were drawn out of national banks alone. This was 20 per cent. of such deposits, and the amount drawn from all banks must have been over 1,100 million dollars.

He further says on page 24:

The financial situation of the past few months was not the result either of a lack in the volume of the currency, of which there is now a plethora, or of a want of elasticity in the present system of issuing it, but arose from a loss of confidence on the part of the people in the solvency of the distinctively monetary institutions of the country. It is worthy of note and of serious consideration that at the very time the scarcity of currency for business purposes was at its height, the volume of currency was increasing the most rapidly. The amount per capita was much larger than in recent years.

Under the same peculiar condition of affairs, which marked the monetary situation from May to September, *no system, no matter how elastic, or volume*

of currency however large, could afford relief. As long as confidence is destroyed and credit wanting, money-hoarding will go on, and additional issues but add to the hoarding, and give but little if any actual relief.

On the other hand, when confidence and credit abound, *there exists little need for an abundant circulating* medium, because under such a condition of affairs the amount of actual money required to transact daily business affairs is reduced to a minimum.

This is a frank and sound declaration, for which ex-Comptroller Eckles deserves credit.

So we see that, if we can retain confidence, there never will be a lack of money for legitimate purposes. Even speculation or large expansion of undertakings does not affect the money market generally. If the 1,100 millions drawn out of the banks in 1893 had been used for such purpose, it would only have changed ownership, passing from hand to hand, from one bank to another. It would still be there, circulating in the marts of trade.

It seems hardly necessary to enlarge on the benefits which would follow the insuring of depositors; they are so manifold, and stand out so clear that anyone cannot fail to discern them.

I know that reminding one of death or paying taxes is not a pleasing subject to dwell upon; but if we feel confident that after death we shall enter heaven, the thought is not so sad; or that after paying taxes we shall find we have made a good investment, and that the continuous fear of a whole nation has been transformed into a feeling of serene safety—to pay taxes would be a pleasure; and such I should consider it.

Some may ask: Why should banks be compelled to insure their deposits? They are now at a great expense to safeguard funds mostly belonging to their depositor, by constructing vaults and safes, paying insurance against loss occasioned by embezzlement or fraud of its employees, paying a watchman to guard their property, and doing all things possible to make safe that which is intrusted to their care. Is it reasonable to ask them to do more, to compel them to insure their depositors? To all of which I answer "yes." The request does not seem to me unreasonable.

When in doubt about a loan, do we bankers not require that it be secured? Do we not agree to pay one hundred cents on a dollar on all deposits? Some may retort: "Yes; but we do not propose to pay for the losses of our neighbor banks." But we must not for-

get that we must and do contribute our mite toward the misfortune or the result of the wrong-doings of others every year of our lives; we should remember that misfortune may overtake any one of us, and may deprive us of the ability to pay our obligations, in spite of our intentions and efforts; and in this case, while directly the banks pay the insurance tax, indirectly they will be reimbursed by the benefits accruing almost from the beginning.

Now, assuming that all which has been said is sound argument in favor of insuring depositors, on what can we base the probable annual loss and its consequent cost or tax; and how can we determine the probable success of such a measure? On this point we need not grope in the dark, since we have the most reliable government reports covering forty years, from the time the national banking system was incorporated to the present time, in which we have a fund of statistics by which the losses may be ascertained; and a better basis of averages on which to calculate the probable future than any insurance company had at its command when preparing its tables.

We will now see what these reports show. My attention was first drawn to an insurance plan when reading ex-Comptroller Lacey's report of 1891, which shows, on page 8, that during the life of the national banking system, a period of twenty-nine years in round numbers, the losses to depositors had been $15,459,000, or an average of $533,000 per annum. The average deposits for the same period were $1,055,000,000, indicating that the annual average loss to the creditors of national banks had been only one-twentieth of 1 per cent.; in other words, if all national banks had paid one-twentieth of 1 per cent. annually on their average deposits, which is equivalent to 50 cents on each 1,000 dollars annually, all depositors would have been paid in full. On the same page it further shows that failed banks which were finally wound up paid on an average 74.17 per cent. in dividends to its depositors; and all the subsequent reports of the Comptroller of Currency to date show about the same result. Now let us see what Comptroller W. B. Ridgeley says in his report of 1902, page 24:

An examination of the reports relating to the liquidation of insolvent national banking associations develops the fact that the total amount of claims proved against all trusts placed in the charge of receivers from the date of

the first failures in 1865 to October 31, 1902, aggregated $139,389,202, and the approximate loss was $37,956,941. Practically the affairs of every bank which failed prior to 1902 have been finally liquidated; and in calculating the total amount of loss, it has been assumed that trusts still open will finally be liquidated at an average loss not greater than 25 per cent.

For the purpose of comparison, there is submitted herewith a statement of the average annual deposits in active national banks, and the ratio of annual loss sustained by creditors of the insolvent national banks, to the average deposits, together with the amount of claims proved, and aggregate an average sustained by creditors:

Annual (average) deposits in national banks from 1865 to 1902	$1,202,871,178
Total claims proved against insolvent national banks..........	139,389,202
Total loss to creditors, actual 1865 to 1892, and 25 per cent. estimate 1893 to 1902....................................	37,956,941
Average annual loss..	998,867
Average rate per cent. of loss on claims......................	27.23%
Average (annual) rate per cent. of loss based on average deposits in active national banks............................	0.083%

This, then, has been the actual experience of our national banking system for a period of nearly forty years, and approximately condensed it discloses the following facts: ten banks fail on an average each year, by which 25 per cent. has been lost to creditors; one million dollars has on the average been lost annually to depositors in banks that failed.

The Comptroller's report of 1903, page 95, shows that national banks paid on capital and deposits, in round numbers, from 1864 to 1883, 68 million dollars, and from 1899 to 1902, 7 million dollars—a total of 75 million dollars—in war tax alone; and they have further paid from 1864 to 1903 a circulation tax of 92 million dollars. It is estimated that the total expenses of the Comptroller's Department did not exceed 19 million dollars, indicating that the profit on circulation alone has been 73 million dollars, which would have nearly paid all losses in national banks twice over from 1864 to 1903. This demonstrates how easily the national banks could have mutually made up the insignificant sum of one million dollars a year, and no depositors would have lost a penny; and a deposit in a bank would have been considered as safe as a government bond, while a banker's standing in the community would have been one of the highest eminence.

When we compare the Baltimore fire, by which a loss of over one hundred million dollars was sustained in a few hours, with the loss of one million dollars a year in failed national banks, this loss in banks seems but a trifle, and shows that the insurance of de-

posits is not so visionary, and not so large an undertaking as is generally supposed. One single fire-insurance company in the United States, with a capital of only $1,250,000, had insurance in force in 1903 of over $1,285,000,000, received nearly $10,000,000 in premiums, and paid a little over $5,500,000 in losses. This company alone could insure all the deposits in national banks, which are now about $4,500,000,000, with far less risk than it is taking now.

As to the legislation required to carry out the insurance plan, the following draft of a bill is submitted, and criticism invited:

An Act to insure depositors in national banks 90 per cent. on their deposits, on the mutual plan, to create and maintain funds therefor, and to amend the National Banking Act.

Be it enacted by the Senate and House of Representatives in Congress assembled:

SECTION 1. That there is hereby created in connection with the national banking system a department in the office of the Comptroller of the Currency to be known as the Depositors' Insurance Department, over which the Comptroller of the Currency shall have full supervision and management, as provided in this act.

He shall receive and disburse all moneys paid in and belonging to the several funds herein provided for, and shall keep suitable books in which shall be kept an account known as the Reserve Fund, and an account to be known as the Premium Fund.

He shall also keep a separate account with each national bank, in which he shall credit said bank with all moneys paid by it to the account of said Depositors' Insurance Department, and shall debit it with its proportionate share of losses paid from said Insurance Funds.

He shall also keep such other accounts as may by him be deemed necessary, and shall have power and authority to appoint such deputies, assistants, and clerks as may be necessary to carry into effect the purposes of this act. All the expenses of this department shall be paid by and charged to the Premium Fund.

SEC. 2. All the surplus funds which may have been derived during the first fiscal year after the act takes effect from the semiannual tax on circulation paid by national banks, after deducting therefrom all expenses, shall be paid in and credited to the Premium Fund in the Depositors' Insurance Department at the beginning of the following fiscal year, and at the beginning of each fiscal year thereafter.

SEC. 3. The Comptroller of the Currency shall invest the money received through the Reserve Fund in interest-bearing bonds of the United States, or of any state, or county, or incorporated city of the United States. Such bonds shall be of the following character: They shall not yield less than 3 per cent. interest on their cost per annum, no interest thereon shall have been defaulted, and no contest shall be pending as to their legality. It is

provided further as to county and city bonds that the indebtedness of such counties or cities does not exceed 5 per cent. of the average assessed valuation for the three years preceding. All the above-named bonds shall be subject to the approval of the Comptroller of the Currency. It is provided further that any national bank may, in lieu of cash payment of its 1 per cent. Reserve Fund dues, deliver to the Comptroller of the Currency bonds of the character above described, at par value, to be approved by him. The interest on all bonds in the Reserve Fund shall be collected by the Comptroller of the Currency when due, and remitted to the national banks proportionately to the amounts paid by them; or in case of national banks that have deposited their own bonds, the interest on such bonds as they may have to their credit shall be collected and forwarded to them. The remitting of interest to national banks shall be made at the end of each fiscal year. Should any of the bonds deposited in the Reserve Fund by any national bank become impaired in value, or interest defaulted thereon, the Comptroller shall require others to be substituted therefor which may be acceptable to him, or else require a like amount in money.

SEC. 4. The Comptroller of the Currency may deposit with the Secretary of the Treasury any surplus money in the Premium Fund; or in case such surplus should accumulate beyond the requirement of the department, he may invest the same in interest-bearing bonds of the same character as provided by the investment of the Reserve Fund, the interest derived therefrom to be credited to the Premium Fund.

SEC. 5. The Comptroller shall make an annual report to the Congress of the United States at the commencement of each regular session thereof, setting forth therein a full statement of the affairs of the Depositors' Insurance Department for the previous fiscal year, and shall make such recommendation as he may believe would tend more fully to carry into effect the intent and purposes of this act.

SEC. 6. Every national bank shall, when this act takes effect or when it shall be organized any time thereafter, file with the Comptroller of the Currency a report showing its capital and total deposits; and at the beginning of each fiscal year thereafter it shall file with the Comptroller of the Currency a report showing its capital and average deposits for the preceding year.

SEC. 7. All national banks having deposits in an amount greater than their capital when this act takes effect shall pay to the Comptroller of the Currency, when this act becomes operative, 1 per cent. on its total deposits, which shall be credited to the Reserve Fund; and 1 mill on its total deposits, which shall be credited to the Premium Fund.

At the beginning of each fiscal year thereafter every national bank shall pay to or receive from the Comptroller of the Currency 1 per cent. on the increase or decrease in its average deposits of the preceding year, which amount shall be credited or charged to the Reserve Fund, and shall also pay 1 mill on its average deposits of the preceding year, which amount shall be credited to the Premium Fund.

SEC. 8. All national banks having less deposits than capital when this act takes effect shall pay to the Comptroller of the Currency, when this act becomes operative, 1 per cent. on their capital, which shall be credited

to the Reserve Fund, and 1 mill on their capital, which shall be credited to the Premium Fund. If at the beginning of the following year the deposits should still be less than the capital, then so much of the 1 mill premium dues paid in the previous year shall be refunded as may be found overpaid on that bank's proportionate share of its average deposits for the previous year; and shall pay for the current year 1 mill into the Premium Fund on its average deposits of the preceding year, and every year thereafter until such deposits shall exceed the capital; the Reserve Fund dues paid in the previous year to remain the same so long as the deposits do not exceed the capital. If, however, the average deposits during the previous year shall have exceeded the capital, then it shall pay on the excess thereof 1 per cent. into the Reserve Fund, and 1 mill into the Premium Fund; and shall further pay for the current year on its average deposits of the preceding year 1 mill into the Premium Fund; thereafter it shall be subject to the same provision as applied to banks in Section 7.

SEC. 9. All national banks organized at any time after this act takes effect, which have been reorganized or converted from, or consolidated with, any other banking association, and have deposits in an amount greater than the capital when so organized, shall be subject to the same provisions as apply to national banks in Section 7, excepting that only such a proportion of the 1 mill Premium Fund dues shall be paid as the unexpired time from the date of organization to the end of a fiscal year shall bear to a whole year, and that payment of dues shall be made at the time when the bank is authorized to do business.

SEC. 10. Any national bank organized at any time after this act takes effect, and having less deposits than its capital when so organized, shall be subject to the same provisions as apply to national banks in Section 8, excepting that payment of dues shall be made when the bank is authorized to do business.

SEC. 11. Whenever a national bank's total deposits at the beginning of a fiscal year exceeds ten times its capital, and if its average deposits for a whole preceding year has exceeded ten times its capital, then it shall on the beginning of said fiscal year increase its capital to such an amount that the average deposits of the preceding year shall not exceed ten times its capital, or else reduce its deposits so that they will not exceed ten times its capital.

SEC. 12. After a receiver has been appointed for a failed bank, and has been in the discharge of his duties for thirty days, such receiver shall make and transmit to the Comptroller of the Currency a statement showing the deposit liabilities of such failed bank, the assets thereof as he may be able to determine, and the assets then available for the payment of the first dividend to depositors; and if the amount so available shall not be sufficient to pay a dividend equal to, or greater than, 90 per cent. of the total deposits of such failed bank, then the Comptroller of Currency shall transmit to said receiver such amounts from the Premium Fund as shall enable said receiver to pay forthwith each depositor on proved claims a dividend of 90 per cent. of his claim.

In case the Premium Fund shall be insufficient, then the Reserve Fund shall be drawn upon for the amount required to pay all depositors 90 per cent. of their claims, and said Reserve Fund shall be reimbursed therefor

as soon as the Premium Fund shall have accumulated a surplus beyond its needs. All the amounts so advanced by the Comptroller of the Currency to the receiver shall remain a first lien on the remaining assets of said failed national bank in favor of said Depositors' Insurance Department. The receiver shall from time to time transmit to the Comptroller of the Currency all the proceeds which may be derived from the remaining assets up to the amount so advanced, and all such sums so transmitted shall be credited to the funds taken from. The remaining assets of such failed national banks after such lien shall have been satisfied, if any there may be, shall be administered by the receiver for the benefit of the creditors thereof.

SEC. 13. Any national bank which shall go out of business, and which shall have paid its depositors in full, shall receive from the Comptroller of the Currency such an amount as shall stand to its credit after having charged against it all its proportionate share of losses sustained in the Depositors' Insurance Department, up to the time of its retirement.

A bank's proportionate share of loss shall be such part of the losses sustained as its average deposits may have borne to the aggregate deposits in all banks for the same period, and as reported to the Comptroller of the Currency.

SEC. 14. Deposits, within the meaning of this act, shall be construed to mean all liabilities of a bank, excepting capital, surplus, undivided profits, unpaid dividends, circulation of said bank, and United States deposits.

SEC. 15. The average deposits of a bank shall be ascertained by adding together the total deposits as stated in the several reports of that bank submitted to the Comptroller of the Currency, and dividing the sum-total by the number of reports so made, or, if for shorter periods, then by the number of days.

SEC. 16. A fiscal year within the meaning of this act shall be construed to mean an entire year from and after this act takes effect and each entire year thereafter.

SEC. 17. Section 5137 of the Revised Statutes of the United States is hereby amended by inserting, after subdivision fourth of the said section, a subdivision thereof as follows:

"Fifth. A national banking association shall be authorized to loan moneys on real-estate mortgages under the following restrictions and conditions: Such loans shall not exceed 20 per cent. of its total loans, and of such amount not to exceed one-fifth shall be on manufacturing plants. The loans on any manufacturing plant shall not exceed one-fifth of the entire actual value thereof and on all other real estate the loan shall not exceed two-thirds of the actual value thereof."

No bank shall make any loan upon real estate until the application therefor shall have been submitted to and approved by the board of directors.

SEC. 18. Section 5139 of the Revised Statutes of the United States is hereby amended by adding after the words "United States Registered Bonds," in the first paragraph thereof, the words, "or bonds of any state, county, or incorporated city of the United States, which bonds are of a character as described in Section 3 and approved by the Secretary of the Treasury; provided that such bonds so deposited shall not exceed 25 per cent. of the total amount required by this section to be deposited."

SEC. 19. Section 5200 of the Revised Statutes of the United States is hereby amended by adding at the end thereof the following:

"Provided, however, that any bank whose total assets exceeds five times its capital may loan to any one person, company, corporation, association, or firm an amount which shall not exceed 2 per cent. of the total assets of such bank; and provided further that such loans in excess of ten times its capital shall be at all times protected by collateral security equal to or greater in value than such loans."

SEC. 20. All acts or parts of acts inconsistent with this are hereby repealed, and nothing herein contained shall affect existing rights of banks which have failed prior to the time this act shall take effect.

It is assumed that, if such an act should ever pass, it would not take effect until at least three months after its passage.

Assuming that such an act were in operation at this date, the reserve fund on the present national bank deposits of about $4,500,000,000, at 1 per cent., would be $45,000,000—a capital which would inspire the greatest confidence. But as we must expect a large increase of national banks, these funds would soon be twice this amount, and the presumption is that the premium dues could later on be reduced.

It is self-evident that as soon as a depositors' insurance plan becomes operative practically every bank receiving deposits other than national banks must reorganize as a national bank, which would improve our whole financial system. As there is nothing which will prevent any savings, state or private bank from nationalizing, provided always that real-estate mortgage loans will be permitted to be made, there will be no hardship in such connection.

Only 90 per cent. insurance is provided for, because there are some objections to full insurance, since the weaker banks would stand on a level, as regards credits, with the strongest bank. It is but fair that a strong bank in high standing, with conservative, honest management, should be appreciated, and that a banker should be encouraged to try for higher ideals. By a 90 per cent. insurance a depositor would still be sufficiently interested to exercise some caution in selecting a bank of the highest credit, while at the same time the 10 per cent. at his own risk would not be sufficient to worry him greatly in a panic, as is the case under the present condition, when in a bank panic depositors are at once possessed of a fear that everything is lost.

Section 2 provides that the net profit on circulation should go

into the premium fund. This profit is estimated to have been for the forty years about $73,000,000, and would alone have paid all losses to depositors in failed national banks up to date, with over $30,000,000 remaining. Owing to the reduced tax on circulation, the net profit last year was about $1,000,000, and the indications are that the surplus revenue from this source alone would be sufficient to make up the deficits of failed national banks, so that all creditors could be paid 90 per cent. on their claims. It would seem that the net profit on circulation derived from the banks, especially when it is to be used for such a beneficent end, should not be appropriated for any other purpose.

Section 11, restricting the deposits to ten times the capital, is for the reason that in some banks deposits far exceed this. The ratio of deposits to capital has increased from year to year, till it now amounts on the average to about $5 of deposits to $1 of capital, and in such cases on a $100 of deposits a bank would have $20 of its own capital behind it, and, with the shareholders' liabilities, $40. Now take a bank which has $20 of deposits to $1 of capital; such a bank on a $100 of deposits would have only $5 of capital behind it, and with the shareholders' liabilities $10; consequently the latter would not be nearly so safe as the former.

Nearly all banks which have ten times more deposits than capital have sufficient surplus, if it were converted into capital, to bring the deposit below the ten-time limit; and under such an arrangement it would be safer, because capital cannot be diverted to other purposes, as surplus funds can. And, besides this, the double liability of the shareholders would add to the resources of a failed bank. Everything being equal, a bank's deposits loses in safety the more they exceed the capital.

Section 17 authorizes a national bank to loan on real-estate mortgages not to exceed 20 per cent. of its total loans. These loans, experience has proved, are the safest, especially to a country banker. They offer a bank a larger field to select its loan from, and thereby enable it to reject a questionable discount, which, if it were confined to these alone, in order to keep its funds employed, it would be tempted to accept. It seems ridiculous to allow a bank to loan on a bare note, and then prohibit it from securing such note by a real-estate mortgage. Good real-estate mortgages, even

if not due, are a quicker asset in a financial panic, when safety is the main question, than a note or discount, even if due, as at such times a banker in most cases does not expect payment, but only extension or renewal. I never lost a dollar on a real-estate mortgage, and in the panic of 1893 they proved to be the best asset of the banks on which cash could be realized. A bank examiner can also determine the value of a bank's mortgage loans by the records better than the value of its unsecured loans and discounts. The more secured loans a bank has, the safer it is. *This section is the most important of the whole act,* as without it many banks could not enter into the national system, which would defeat the purpose of this act.

Section 18 provides that 25 per cent. of state, county, or city bonds may be deposited against circulation, instead of United States bonds exclusively. These bonds are practically as safe as government bonds. All saving banks, loan, trust and insurance companies have taken these for years with hardly any loss, and they have not all been safeguarded as herein provided. If the time ever should come when our government debt is so reduced that the outstanding United States bonds will not supply the security required against circulating notes, then the 25 per cent. municipal bonds above provided for could from time to time be increased, and thereby our secured currency perpetuated.

Section 19 increases the amount of a single loan over one-tenth of a bank's capital, as soon as a bank's assets exceed five times its capital. The present restriction is not based on a correct principle, and is so frequently disregarded that it would be far better to increase such loans. A similar amendment has several times been recommended by ex-Comptroller Charles G. Dawes.

The reason why I take such an interest in insuring depositors in banks is perhaps the many bank failures in my county, through which I could not fail to observe the suffering and worry and anxiety of the people over the safety of their money. In 1855 the first bank was organized in my city. It failed soon after. From time to time five more banks were organized, and all but one failed at different times, till in 1893 all had failed in our city and county but one. A banker came to be regarded as about the worst rascal in our community. I remember that in 1893 my best friends

avoided being seen in my company for fear they might be judged by the company they kept, although I was not involved in any bank failure. But this made no difference. The innocent had to suffer with the guilty, and so I bore it philosophically as a martyr.

The generally entertained suspicion that most bank failures have been caused by fraud is quite erroneous. During my banking experience I have found that, with but few exceptions, bankers have all striven to act most honorably; but somehow they fail to realize the continuous vigilance and prudence required in investing safety and profitably other people's money, being often tempted to invest in venturesome undertakings promising large returns, but in most cases turning out disastrously. Very rarely a banker fails with the intention of profiting thereby, and I do not believe there is one in a thousand failures which can be attributed to such a cause.

The exceptionally numerous bank failures in my county are not a criterion to be applied to our whole country; but I feel quite certain that of all the money in our county there is at least 20 per cent. hoarded, while 80 per cent. is deposited in banks; and we may safely estimate that it will not be far from *10 per cent. in our whole country,* which would be in banks if they were insured.

But I do not advocate the insurance plan for the purpose of getting a material benefit out of the money now hoarded; for if the objection advanced against this plan should prove true—namely, that the stronger and more reputable banks would lose by it—then the bank I represent would surely share in such loss. I am actuated solely by a confident belief that in the near future the deposits in banks will be insured, either by corporation or by means of postal savings banks, which would be a great detriment to all banks. I also believe that it would be of incalculable benefit to the whole people, of which I am a part, and I do not fear that I shall not get my share of its accruing benefits. That the people will welcome with unanimity the advent of any measure which will lessen the worst mental agony they have to suffer will not be questioned.

The ample time given before the next session of Congress will enable all interested to investigate the proposed plan most thoroughly, and determine and discuss its merits. If the bankers could give this plan their approval, there would be nothing in the way of a speedy enactment of a law by which the insurance of deposits could be made an accomplished fact.

PANIC PANACEAS

ADDRESS DELIVERED BY ANDREW JAY FRAME, PRESIDENT OF THE WAUKESHA NATIONAL BANK, WAUKESHA, WIS., BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW YORK CITY, SEPTEMBER, 1904.

OUR battle for the world's standard of value has been practically won. Now the paramount economic question before the American people is: How can we minimize conditions which produce panics, and also ameliorate their after paralyzing effects?

Panics undoubtedly cannot be prevented, because it is impossible to change human nature; because nature is unlikely to be less fickle in her gifts to man; because prosperity and adversity follow each other as surely as the tide rises and falls; because, where the rising tide of prosperity appears and a few clear-visioned Napoleons of finance make quick fortunes, the masses lose their conservatism and riotous speculation ensues, resulting often in panic. Notwithstanding this, I am a firm believer in ameliorating panic conditions, both as to their frequency and their severity. But how? My answer is:

1. By studying history and profiting by the experiences of the past.

2. By passing conservative and sound banking laws, and then enforcing them.

3. By providing cash on sound lines to meet extraordinary demands, and immediately retiring it as soon as the pressure for funds is over, to prevent inflation, and also to be ready for the next emergency.

The *Standard Dictionary* epitomizes conditions leading to panics as follows: "An undue expansion of loans (by banks), an unsound standard of value, over-extension of mercantile credits, and widespread speculation are forerunners of panics." Let us never forget that *confidence upbuilds and distrust paralyzes.* The blighting effect of distrust in our standard of value which was the main underlying cause of the panics of 1873 and 1893 has given to our people convincing object-lessons, more potent than pages of logic, that a 100-cent dollar is indispensable to stability and prosperity. Populists alone dissent. They attempt to live by their wits, and generally fail for lack of capital. I-O-U's are not capital. With these calamitous conditions vividly before

us, the result has been a campaign of education and legislation which has practically eliminated from further discussion the "unsound standard of value." Absolutely to eliminate all distrust, the language of our statutes should be so unequivocal, as to the redemption of our vast volume of silver coins in gold on demand, that no man would dare disobey its mandates.

In the limelight of historic facts, in proof of the value of good banking laws, let us consider only the brief period of the past forty years. Permit me to refer to the report of the Comptroller of the Currency for 1896, on pages 33, 34, and 54, as to the failures of banks. These pages do not cover yearly nor local history, but United States history as to national and state banks for the long period from 1863 to 1896. In that period 330 national and 1,234 state banks failed. During this same period the claims filed, dividends and percentage paid to depositors, and amounts still unpaid were as follows:

	Claims Filed	Percentage Dividends Paid	Still Due of Creditors
National Banks..................	$ 98,322,170	63 $\frac{8}{10}$	$ 35,556,026
State Banks......................	220,629,988	45 $\frac{4}{10}$	120,541,262

Please note that further dividends have since been paid, as the later failures were not entirely closed.

Permit a further reference to a most excellent address along the same lines, which all seeking light should read, delivered by Comptroller Ridgely last April before the Society of Political and Social Science at Philadelphia, entitled "Government Control of Banks and Trust Companies." The Comptroller says, in referring to this same report as "the last date to which complete figures are available":

> It will be seen that, while only 6.5 per cent. of the number of national banks in existence failed during this time, 17.6 per cent of the other banks in existence failed. And while the national banks which had failed up to 1896 (and were entirely closed) paid to their creditors 75 per cent. in dividends, the state and other banks paid only 45 per cent. . . . . The total loss to depositors in forty-one years has been less than thirty million dollars.

This estimate doubtless is intended to cover the net losses when all the affairs of failed national banks to this date are entirely closed.

By way of digression, when this result is compared with the deficiency of thirty-five millions of dollars resulting from the failure of the City of Glasgow Bank, with its 131 branches in 1878, our national banking system looms up so grandly that every American citizen has reason to be proud.

On the other hand, something must have been radically wrong in at least some of our state banking systems when we compare the number of failures, amount of losses, and percentage paid to depositors, as shown in the above table.

Does any doubt that these widely divergent results were brought about by an enforced conservatism under the National Bank Act, as against good banking laws in a few states, lax laws in some states, and no laws in many others? It is cause for congratulation that the states are awaking, although too slowly, to the necessity for better conditions. A few years ago the Wisconsin Legislature passed a good state banking law, and the people vetoed it. She later redeemed herself. May the good people of Ohio redeem themselves from a like folly committed last fall! With ten thousand millions of dollars of deposits in the banks and trust companies of the United States due to not less than fifteen millions of depositors, in order that conditions leading to panics and their paralyzing effects may be minimized, is it not the clear duty of our statesmen to perfect, as far as possible, conservative laws along sound lines? I will suggest but a few of the salient features.

1. No bank of any kind should be allowed to open without ample paid-in capital as a guarantee fund, before the innocent depositors intrust their funds with it. History teems with trouble resulting from wild-cat banking. Possibly mutual savings banks, which ought to accumulate a surplus, might be excepted.

2. A limitation on loans to a certain percentage of capital—to which I will add, surplus (which is not included in the National Currency Act)—to any one individual, firm, or corporation.

3. Requirements of reserves against demand liabilities. The cash reserves can consistently be lowest with the savings banks and trust companies, because their deposits are largely subject to time notice before payment. That time limit in times of trouble should be rigidly enforced, as it was lately in St. Louis, where a foolish

panic was undoubtedly prevented by prompt action in this respect. The limitation for commercial banks, as laid down in the National Currency Act, is eminently sound and inspires conservative management. Although the rule is often broken in times of crises, I think no bank that was solvent has ever been closed by the Comptroller for that cause. Reason reigns at such times and not the rigid letter of the law. Some fifteen or twenty years ago I said to Lyman J. Gage, then president of the First National Bank of Chicago: "You keep a generous reserve of cash on hand." His answer came quickly: "I should not sleep nights with less than 40 per cent." This lusty child seems to keep on growing while others have fallen by the wayside. Let history speak as to who survives longest, the conservative or the plunger.

4. The rate of interest paid to depositors must be left to the individual bank and cannot be regulated by law. It is just cause of some concern now that fierce competition in several quarters in this respect is likely to produce unpleasant results. Thrice within my forty-two years of banking experience, banks in a certain city mailed broadcast offers to pay interest on account in excess of the current legitimate rate paid by other banks. Depositors that took the bait, within a year thereafter, got bitten by failure of every one of those three banks. Moral: Avoid banks paying more than normal rates of interest, as the probabilities are "there is something rotten in Denmark." This moral will apply to individual depositors as well as to banks with banks.

5. The question of value of supervision of banks is simply beyond controversy as to beneficial results, and I will therefore pass it. If experience proves there is such a marked contrast in favor of safety to depositors in national banks, which are under careful laws and supervision, as against all other banks, which are only partially so, is it not a reasonable and sound conclusion that the meat of the whole matter lies in making good banking laws, then enforcing them by strict examinations, closing up the insolvents, and not allowing them to dissipate good assets for years after insolvency, as has been the case all over our country? Limit failures, and panic conditions will be ameliorated. Good banks ought to court investigation, and the people should insist on rigid investigation of all banks to weed out insolvents. Let us give to the fifteen

millions of thrifty people of the land who intrust ten thousand million dollars of their hard earnings to our care all that protective, wholesome laws can give, thus broadening confidence, and failures will be less calamitous.

The savings banks and trust companies each have their legitimate sphere and should be regulated on conservative lines, according to their methods of doing business. Less reserves are required, as they have less demand liabilities, and many of their loans are of a different character from those of a strictly commercial bank. All banks doing a commercial business, and to the extent of their demand liabilities, should be governed somewhat on the lines of the National Currency Act—the safest bank act ever devised by man. Comptroller Ridgely asserts that the national system has "an unequaled record of soundness and safety." A careful examination of the world's history conclusively proves his statement. We must not forget that Old World banking is subject to practically no supervision or regulation comparable with the National Currency Act.

Nevertheless, in view of the fact that national banks are not increasing in the same proportion as other banks—due, doubtless, as stated by the Comptroller, to the desire "for greater freedom from control, weaker reserves, and less careful management"—there is no doubt that many national bankers are chafing under some of the rigid rules of the act, especially limiting to 10 per cent. of capital, loans on public market cash collaterals, and in country towns, where commercial paper is scarce, to a limited amount of loans on mortgage. Perfection is impossible of attainment. Reason alone should reign, and if the lines of regulation are drawn more closely, I fear the downfall of the system will take place. In the interest of the great public benefits at stake, may not over-rigid regulations destroy this most beneficent act?

When panic threatens, the profoundest problem is: How can it be prevented or ameliorated so that banks can promptly respond to the insane demands of the frightened depositors for cash, and how can the banks be put in condition to discount freely to all solvent parties, in order to prevent the paralyzing effects of the collapse of trade and industry in all branches, which is inevitable when forced liquidation takes place, and which is so destructive to labor

and capital alike, in substituting soup-houses and tramps where the hum of buyers and sellers ought to be uppermost? Political economists in all ages have wrestled with this knotty problem with indifferent results.

Professor Sumner, in his condensation of the celebrated "Bullion Report of 1810" to the House of Commons, says: "In the presence of a panic the duty of the bank is to discount freely to all solvent parties." And although Sumner says, "Its doctrines are the alphabet of modern finance. They are no longer disputable," yet no provision by law was then nor since made to provide cash to pay frightened depositors and to discount freely to all solvent parties.

The banks of Great Britain in 1844 were restricted on issues of bank-notes to the amount then outstanding by the banks then existing. Seventy per cent. of the right of issue of those banks which have closed since 1844 has reverted to the Bank of England, thus reducing the total uncovered issues allowed to banks in general, all of which are subject to the Unlimited Liability Act as to note issues, to the small sum of approximately £8,000,000, and has increased the issues of the Banks of England since 1844 from £14,000,000 to about £18,500,000, based on securities. All other issues of the bank are covered with gold coin or bullion, thus making the notes practically a gold certificate and giving the Bank of England the sole right of issue in Britain. As extraordinary troubles require extraordinary remedies, in order to ameliorate some of the calamitous panic conditions which have overtaken Britain, history says that the Bank of England in 1847, 1857, and 1866, after the panics had paralyzed its progress, on the assurance of the government officials that no prosecution would follow, suspended the Bank Act as to issuing notes only on the deposit of a like amount of coin or bullion, and issued notes to the banking department on deposit by it with the issue department of ample securities. This was an unlawful act, giving elasticity to the currency, but it placed the banking department in an easy condition to "discount freely to all solvent parties." Again in 1838 the bank borrowed £2,500,000 from the Bank of France during panic conditions, and in 1890, during the Baring troubles, she borrowed £3,000,000 more; also £2,000,000 from other sources; and the

panics were stayed. The apparent necessity for these extraordinary acts was that the country had reached a commercial crisis where good securities could not be sold for cash. Suspension and consequent ruin were staring sound commercial houses and banks in the face.

In each case the action of the bank afforded instant relief, and doubtless saved hundreds of millions of dollars to tottering houses unable to meet payments except for such relief. As soon as the pressure was over, the illegal issues were retired.

As history shows conclusively that financial revulsions in Great Britain in the past sixty years have been more calamitous than those of our own country, thus disproving the claims of the advocates of branch banking and asset currency that they are a panacea for panics, and as the commercial banks of Britain carry about one-half as much reserve against general liabilities as ours, are we not justified in concluding that an insufficient reserve is at least one of the underlying causes of their troubles? If so, we can consistently join in the just criticism of the *London Economist* in asserting that Great Britain's 4 per cent. of coin reserve, against the £825,000,000'of liabilities to the public of her banks, is clearly the cause of the sensitiveness of her money market. The *Economist* advocates a reform of Peel's act of 1844, advises larger reserves to preserve confidence, which has so often been rudely shaken and which is necessary to all progress and stability, and says that probably nothing short of a cataclysm will demonstrate the necessity for such change. Britain's proverbial lethargy in this respect is paralleled by her tenacity in holding to her antiquated railway cars and her abominable pounds, shillings, and pence. Should Britain provide for larger reserves, which are about half of ours, and legally empower the Bank of England to relieve extraordinary pressure on the same lines as in 1847, 1857, and 1866, before paralysis takes place, she doubtless would minimize serious panic conditions, as far as it is possible to do so.

The Bank of France has had the sole right of issue in France since 1848, and to-day has the right to issue $1,090,000,000 of notes, and is not restricted to the holding of coin or government securities for every dollar of notes issued, but voluntarily, in respect to reserves against note issues, follows nearly the same line

as does the Bank of England. Its coin reserves have approximated 85 per cent. of about $800,000,000 average note issues for some years past. Under very conservative management, the right of issue has been so carefully guarded that France, although subject to financial revulsions, has doubtless escaped serious trouble at times. We must not forget that the Bank of France is more a bank of issue than a bank of deposit, as its deposits are exceeded to-day by both the National City Bank and the National Bank of Commerce of this city, while the First National Bank is a close third. New York City is certainly forging rapidly upward as the world's financial metropolis.

With the exception of only five banks, which are allowed to issue eighteen millions of dollars of uncovered notes, the Imperial Bank of Germany monopolizes that right. The bank is allowed to issue now about $100,000,000 uncovered circulation under certain restrictions. Any excess over that sum must pay 5 per cent. interest per annum to the government for the right. This excess issue is the only true means of obtaining relief under panic conditions, as the interest rate will certainly retire the redundant currency as soon as the pressure for funds is over, thus preventing inflation, which must be guarded against as one would guard against an insidious disease.

If we add to the foregoing Austria, Belgium, Netherlands, Norway, Denmark, and Russia, which have only one bank of issue each, and all are under such careful restrictions as to coin reserves against notes that their combined uncovered circulation approximates but a little over $600,000,000 as against nearly $600,000,000 uncovered circulation in the United States alone, we should be impressed that, if we are to be guided by the experience of older nations, we must discard the thought, as they have done, of the right to issue uncovered notes except through the great centralized institutions, and then only as temporary relief measures and not for profit. If we except Britain, all the countries named have provided, through their great centralized banks, for currency issues under careful restrictions, which generally gives the relief sought by us. A circulation issued by banks, with material profit in it, means expansion. If the big and little banks of this country were to throw out a life-line at will to the over-buoyant in the shape of

asset currency, I fear the plungers would be swimming beyond their depth continually; therefore some relief measure, under careful restrictions to prevent inflation, should be found for use under panic conditions. If the banks of Europe and three-fourths of those in the United States survive and prosper without circulation, why cannot the other quarter survive on the same diet? The national banks profited in their early years on circulation because bonds drew high rates of interest, and thus they were fully compensated for their patriotism; but now the profit is so slight that few banks care a continental whether they issue currency or not.

As the quality of our money is fixed, and under natural economic laws the quantity is ample for all legitimate requirements; as the ebb and flow of gold from nation to nation, which no barrier can stop, is governed also by those same natural laws; as the fluctuations in the rate of interest, coupled with these natural laws, are the proper barometric signals that ought to inspire conservatism and check undue expansion of credit when rates of interest are above normal, why should we be eternally tinkering with the quantity of money in the country? Many good men believe interest rates can be equalized by currency issues. All history disproves the theory.

It is a maxim of political economy that when the quality is fixed in rich countries, the needs of commerce will settle the quantity. Professor Jevons asserts that under such circumstances the last thing a statesman should do is to attempt to regulate the quantity. Therefore, if ordinary occasions are provided for, the paramount question is: How can we provide cash to pay depositors and to loan to all solvent parties when panic threatens, and have that cash return to its reservoir as soon as the pressure is over, to prevent inflation?

Shall we adopt the European method and establish a great central bank with conservative powers, to accomplish the object sought? Or shall we provide, through several thousand independent national banks, for the issue of credit currency as such relief measure? The consensus of opinion seems to answer "No!" Personally I do not see any serious objections to a great central bank as fiscal agent for the United States and as a bank of the banks, somewhat on the order of the Imperial Bank of Germany, or

on the order of the Bank of England, but with full power legally to issue currency under a 5 per cent. per annum interest rate on deposit of securities, as was done by the Bank of England in 1847, 1857, and 1866, as an elastic or emergency measure to throttle panics in their incipiency. But I suppose the banks holding government deposits would object.

The nearest sound solution of the second question comes from our able Secretary of the Treasury, and also from the committee's conservative report of last year before this convention. Both advocated the issue of relief national bank notes in excess of present issues, under a 5 to 6 per cent. interest penalty to insure its retirement after the temporary pressure for funds is over. This tax, which is the essence of soundness, in compelling the return of the extra issues back into the reservoir to be ready to quench the next fire and also to prevent inflation, has been, to my mind at least, altogether too freely criticised. I fear that some critics have allowed selfishness as to profits to outweigh the necessity for relief. Many good men have declared they would issue no currency and pay 5 per cent. on it. Under ordinary conditions, of course, we would not; but under extraordinary conditions, when frightened depositors are demanding cash; when country bankers are necessarily withdrawing reserve balances, and solvent merchants and manufacturers are calling for loans to pay bills and keep the wheels of commerce from being stilled, where is the banker that will not temporarily provide cash, if possible, at a 5 per cent. interest rate, to meet these demands, instead of slaughtering sound securities in markets, when at such times even government bonds cannot be sold for cash except at ruinous prices? Let the old, experienced banker, who has been through this mill, answer. It seems to me that we all ought to subscribe to the committee's report, if we could but confine such issues to the great, centralized banks.

National calamities are not born in country towns. Panics are bred in great cities, where colossal promotions flourish; where most—not all—banks fail to reduce interest-paying rates when money is easy; where the cashier is discharged (according to Secretary Shaw's witticism) when the board of directors find him with $50,000 surplus reserve; where the reserves are loaned to the stock jobbers that ought to be held to meet the call of the country

banks for their own deposits to move the crops. Then, when the stock jobber is called upon to liquidate, he must attempt to rob Peter to pay Paul; but, because of the lack of a proper cash reserve generally, stocks decline on forced sales to obtain cash, and general liquidation takes place.

This fall doubtless will be an exception. Last year, in my debate with Congressman Fowler on the asset currency question before the Wisconsin State Bankers' Association, I challenged any man to prove that since 1893 there had been more than two fall seasons when the money market was above a normal or reasonable level, and then speculation, and not crop movements, was the primary cause of trouble. The *Wall Street Journal,* in an able editorial, said my case was won if I could prove that assertion. I reiterate it. The best condensed proof is in the *Annual American Encyclopedias* since 1893, under the caption of "Financial Review," to which reference is respectfully made.

Conservative people in all pursuits do not allow a little surplus cash to burn their pockets when they know extraordinary payments will soon require its use, and bankers ought to be the leaders in conservatism. If the central cities are the occasional sinners, why should they not provide the occasional remedy? Again, they are far better equipped with the right kind of cash collaterals on which to base these temporary issues.

In the consideration of this all-important question, permit four suggestions:

1. Why not empower the government to issue but one kind of note—to wit; a legal-tender note payable on demand in gold coin—and substitute it for all other government issues of legal-tender notes, as well as gold and silver certificates; then accumulate from surplus revenues additional gold equal to all uncovered outstanding legal-tender notes, thus simplifying and absolutely settling the quality question of all government issues?

2. To prevent locking up money in the treasury, provide for depositing all surplus funds over current requirements in the banks.

3. Raise the limit of reduction of national-bank notes from $3,000,000 to $6,000,000 per month.

4. At the session of this convention in San Francisco last year, in discussing the report of the currency committee, which allowed

all national banks to issue emergency currency, secured by a deposit of securities with the Treasury Department under careful limitations and a 6 per cent. per annum tax, I voted for that report because I agreed with its underlying principles and only differed in detail. May I briefly reiterate the reasons therefor, as we need all possible light in settling this all-important question, with the largest possible safeguards against abuse?

The committee's report confines relief to national banks alone. I do not see why the Manhattan Company or Bank of America in New York City, the Illinois Trust & Savings Bank, of Chicago, or Wells, Fargo & Co., of San Francisco, and kindred organizations, should not be entitled to the same assistance. I would therefore grant such relief to the great centres through their clearing-houses by legalizing "clearing-house national-bank notes" on practically the same form as present issues. Any member of the clearing-house desiring such advances, must deposit with the clearing-house ample cash collaterals approved by its committee. The clearing-house certificates should be forwarded to the Comptroller of the Currency and exchanged for such notes—5 per cent. interest being charged from the date of such issue to the day the borrowing bank deposits funds with the United States Treasurer to redeem the outstanding notes. The certificates will then be returned, exchanged for the deposited securities, and canceled. Such advances should be held as strictly private.

This method will provide extra cash, not only to national, but to state and savings banks, trust companies, or any other clearing-house banks, in times of financial stress. Country, banks in calling for their own deposits, will not, as heretofore, be met with the reply: "No currency is going out of the city." The burden upon the reserve cities will not be great, because $33,000,000 in clearing-house certificates in the 1873, and $66,000,000 in the 1893, panic sufficed to restore confidence.

With this method, no political tinkering will break down the bars, but the conservatism of the clearing-house committee will prevent unnecessary issues, the rate of interest will prevent inflation, and redemption will automatically take place as soon as pressure for funds is over. This method is far better than the clearing-house certificates of 1873, 1884, 1890, and 1893, because it provides cash

to pay depositors and to loan to all solvent parties, and also to meet country demands, whereas certificates could not. It is equal in effect to the 1847, 1857, and 1866 Bank of England illegal issues, which allayed panic conditions at once. It will check the bears in their Black Friday onslaughts. The Secretary of the Treasury could then heave a sigh of relief from pressing importunities. When one is seriously ill, doping with sweetened quack medicine rarely relieves, but unpalatable medicine may be necessary to recovery. Knowing periodical distress will come, why not provide a remedy on lines unquestionably sound, which we know will relieve, if not absolutely cure? In the matter under discussion the trend of all progressive countries is toward the concentration of the power to issue emergency currency. May the statesmen of this country, which is advancing by leaps and bounds far ahead of all competitors in general progress, not fail to provide such relief in some form, the benefits of which will be incalculable! I care not what that plan may be, provided it be on such sound lines that our standard of value may never be tarnished, that distrust may be dispelled, and confidence, that bulwark of all progress, may be ours to the fullest possible extent.

FINANCIAL CRISES

ADDRESS DELIVERED BY THEODORE E. BURTON, MEMBER OF THE HOUSE OF REPRESENTATIVES, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW ORLEANS, NOVEMBER, 1902.

In order to understand the nature of financial crises it is necessary to study the whole field of trade and industry. They are not independent events, but bear close relations to changing conditions in the business world. At the outset it is necessary to define three terms: Financial crisis, depression, and poverty. John Stuart Mill has defined a financial or commercial crisis as follows: "There is said to be a crisis when a great number of merchants or traders at once either have, or apprehend that they shall have, a difficulty in meeting their engagements." The crisis which he defines is essentially financial. It is most keenly felt at banks and in financial

centres. It may occur when trade and industry are not seriously affected. It is of brief duration, and may or may not be followed by a prolonged disturbance. A crisis is, however, usually a signal or introduction for a period of prolonged disturbance, during which a decided change for the worse occurs. This disturbance may be described as a depression or a period of depression. A depression may be briefly defined as a protracted season in which the activities and profits of industry and trade fall materially below their normal level. Poverty describes a condition still more prolonged than a depression, and one which is of a permanent nature. Crises and depressions appear in highly-developed countries where trade and industry flourish and there is a rapid progress. Poverty exists where there is a general condition of stagnation, and development either does not exist or is very slow. Crises and depressions are severe in countries which from decade to decade show the greatest increase in wealth and material prosperity. An eminent financial writer has said: "Paradoxical as it may seem, the richest of nations can be measured by the violence of the crises which they experience." If instead of "richest nations" he said "rapidity in material development of nations," this statement could be accepted as substantially true.

In order to explain this singular phenomenon, that the most advanced and progressive countries suffer most from crises and depressions, it is necessary to seek their causes. Their underlying causes can be traced to the inevitable changes which characterize modern industrial and commercial progress, to the aggressive spirit and energy of progressive peoples. These changes require the constant absorption of exceptionally large amounts of capital in great enterprises, the completion of which requires a considerable time, or which when completed are not immediately profitable. This class of investments disturbs the normal relation between expenditures for the future and those required for early utilization. Illustrations may be found in such instances as the building of the great trans-continental railways, the Hoosac tunnel or the underground railway in New York City, or the investment of capital in great establishments which are made necessary to meet some new demand of public utility or convenience. Equally disturbing are those changes in methods of production or manufacture occasioned

by inventions, or by improved machinery and methods which require the substitution of new appliances and equipment for the old. These changes require the loss of much of the investment which has been utilized for prior demands of production. Material and appliances which have been used to furnish supplies are abandoned to the scrap heap, and great investments of capital are lost. An incident of this progressive tendency is the unequal development of invention in different lines, and greater profits in certain branches of business or manufacture than in others. As a result of this there is an absence of equilibrium between different lines of production; too much is produced of some things, too little of others. In a period of advancement also, when there is an increased demand for the necessities and luxuries of life, there is an inevitable tendency to over-action, or to engage in an unusual number of unprofitable undertakings, manifesting itself in seasons of expansion by an unusual amount of speculation and fraud.

The course of advancement is marked by a demand for increased production, which stimulates enterprise. This is attended first by a rise in prices, then by a great increase in the equipment for production, and later by an over-supply, which causes prices to fall. In the course of these disturbances, prices almost always reach and pass a maximum before a crisis occurs. The crisis comes when, instead of a demand greater than the supply, the supply is greater than the demand, and there is a glut in the market. Manufacturers and traders are confronted by slower sales and by diminished profits. In the banking business the visible indications of the approach of a crisis are an increase of loans and discounts; that is, an increase greater than that which is required by the ordinary expansion of trade and industry; by a decrease of deposits, at least of deposits not based on discounts; by a rise in the rate of interest, or a scarcity of available money; also by a decrease of specie and of bank reserve.

One of the most accurate indications of healthful financial conditions or the reverse is the relation between specie and loans, as shown by the statements of the banks. In the first half of the last century this was the infallible indication. While this same indication now forecasts the approach of a crisis, it is much less prominent. The same conditions which have caused its diminished

prominence as an indication have also lessened the severity of crises. Among them are the growth of international financial relations, and the recognition of a general interest which renders it desirable that the stronger should support the weaker, and that all should unite in giving attention to localities or interests where disturbances exist. As a result, assistance is rendered where support is needed in time of stress. There is also the adoption of substitutes for money, which diminishes the strain on the monetary supply, metallic or paper; the larger capital invested in the banking business; the custom of increasing the rate of discount at a time when gold reserves begin to diminish, and, as important as anything, the greater skill and prudence exercised by bankers.

In the consideration of crises in our own country it is necessary to take into account certain exceptional conditions which have existed or which now exist here. Among the most notable causes of crises in the United States in the past has been the lack of certainty that paper money would be redeemed in specie, and in the standard of values, whether it should be gold or silver. Great losses and great disturbances have arisen from the evils of irredeemable paper currency. A further injury has arisen from frequent changes and constant agitation, in regard to vital matters of economic and fiscal policy, such as tariffs and the issue of paper money. Happily, recent legislation has given assurance of the maintenance of the gold standard, and public sentiment has unequivocally declared against sudden changes in economic policy.

The notable defect at the present time is the absence of elasticity in our currency, with the resulting scarcity at times when large quantities of money are required, and the tendency to speculation when money is redundant. It requires little discrimination to discover that the demands for money are unequal at different seasons of the year, and in the same seasons of successive years. The term "autumn drain" has been applied to the great demand for currency in the autumn season. It is clear that the quantity of paper money should be so regulated that it may increase or decrease according to the requirements of trade. The function of the treasury as a bank of deposit also has an injurious effect, because of the tendency to lock up money in the government vaults when it is most needed, and to disburse it in large quantities when a less supply would be sufficient.

A remedy for these two conditions, the absence of elasticity in the currency and the accumulation of money in the treasury, has been advocated by those who say that the government should go out of the banking business. The issuance of greenbacks in the time of war was clearly intended as a temporary expedient. President Lincoln, in his message of December 1, 1862, seemed to take the view that the United States notes were of doubtful expediency, and to regard the issuance of paper money as the function of the banks.

While the proper custody of government money presents a different problem, it would seem that some method might be devised under which a limited amount, as nearly equal as possible, from month to month, might be retained by the treasury, and the balance made part of the circulation.

For the practical management of banks with a view to prevent crises no rules can be formulated better than those stated by Mr. Bagehot: First, that in the time of alarm loans should be made only at a very high rate of interest. This course, he says, will operate as a heavy fine on unreasonable timidity, and will prevent borrowing out of unnecessary precaution. Second, that at this high rate loans should be made on all good security and as largely as the public asks. He says, "What is wanted is to diffuse the impression that though money may be dear, still money is to be had."

The question when another crisis will occur presents an interesting inquiry. The answer is rendered much more difficult by the different conditions which prevail preceding each successive crisis, and especially at the present time. The exceptional conditions of the present are much more marked in our own country than elsewhere. We have attained a commanding position unknown in any other country. Our development has not only been great, but it has been attended by an unusual degree of equilibrium between production and consumption, by skill and aggressiveness in obtaining access to new markets, and by a recognition of community of interests not known before. In several foreign countries, if we may judge by the ordinary indications, the unequaled prosperity of recent years has reached and passed its zenith; but such does not seem to be the case in the United States, though surely a

diminished purchasing power in other countries must in time have an injurious effect upon our country.

One general factor of the most important nature, which cannot be overlooked in the present situation, is the great increase in the production of gold in the past ten or twelve years. This increase stimulates trade by increasing the monetary supply and by rendering it easier for the debtor to meet obligations. Such an increase would naturally be attended by a very considerable increase in prices; but this increase in prices has been very much diminished by the cheapening processes of invention and by improvements in manufacturing and in transportation, and in the methods of managing business enterprises. An increased supply of metallic money has usually been attended not only by a wholesome increase of wealth, but also by an unhealthful stimulus to industry, which in time causes over-action and results in a crisis; but the present development is marked by such harmony and such adaptability to new conditions that the injurious results which attend an increase of metallic money have not been felt so much as in previous years. It must be expected, however, that so great a prosperity cannot continue without abatement. Still it is certain that such crises as may occur will be but temporary checks in the great forward movement. This is especially true in our own favored land. Our aim should be to establish such a degree of steadiness, and to exercise such a caution in our business growth, as will reduce to a minimum the deleterious effects of crises and depressions.

ECONOMIC WASTE OF OUR TREASURY SYSTEM

ADDRESS DELIVERED BY LYMAN J. GAGE, EX-SECRETARY OF THE TREASURY, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT MILWAUKEE, OCTOBER, 1901.

IN every country there is a more or less intimate relation between government finances—debt and taxation—and the general commercial or industrial affairs of such country. In our own country that intimacy has been and is injuriously close. Does this need any demonstration? I think not. The facts of history

are too familiar, and memory readily recalls those periods when our whole financial and industrial progress has been severely checked, while great questions relating to the condition of the treasury or the standard of money have awaited decision. It has been the effort of your association from the beginning to assist in establishing the government finances on secure foundations, and at the same time to reduce to the smallest degree possible the dependency of commercial affairs upon treasury operations. While under our system the government, in a broad sense, is the people, and the people constitute the government, yet in its organization it is a legal entity, separate, distinct, impersonal. It is a corporation with rights, duties, obligations, all clearly set forth and defined in the Constitution or in statute law. Within its proper sphere of action it is supreme; but its proper sphere of action is limited, and it cannot transcend these limits without harm to itself and injury to the people. In other words, there are laws superior to the government—laws which it cannot defy and escape penalty. They are not written laws, but are discoverable. They are varied in form; but I refer now only to the higher economic laws, which have a way of self-operation, blessing the obedient and banning the violater. Of these all men and all governments should be afraid, and to their mandates respect should be shown. The thought I have in mind will be the more distinctly presented by a contrast between the expressed principles of a neighboring state, and our own governmental methods as they have been made familiar to your knowledge and experience.

Some time since I had the pleasure of a long talk with the financial Minister of a South American republic, one of the most securely established in its political life and most advanced in the elements of material growth and industrial prosperity. Desiring to know his government's methods, and their points of view in certain economic particulars, I asked him a series of questions, to which he made the most gracious and frank replies. I confess that I was surprised and not a little humiliated, as a citizen of this great Republic, at the clear perception of economic relationships, and the evident willingness he displayed to forgo tempting advantages in the present, out of obedience to the requirements of higher considerations. I do not believe that I can do better than to repeat

the substance of that conversation. It throws some clear side-lights on our system of finance.

"You have," I asked him, "some sort of banking system in your country?"

"Oh, yes. We have a system operating under federal authority, governed by federal law, and subject to inspection and control by federal agents. We have eight large banks, each with several branches, so that all sections of our country are supplied with banking facilities."

"Why do you allow banks with branches? Why not make them entirely independent of each other, the same as we do?"

"Well, we believe that a fagot of many twigs is safer and stronger than the separated twigs could be. It has worked well. We have had no bank failure for many years."

"Do they issue notes to circulate as money?"

"Yes, limited in amount by their relation to capital, and by the percentage of specie which they are required to carry against note issues."

"Why do you not make the banks secure their notes, as we do, by the pledge of your government bonds? By requiring them to do this, you would enlarge the market for your securities, and thus lower the rate of interest on your government debt. At the same time you would make the bank note absolutely secure to the holder."

"Yes," he replied, "but this apparent advantage might prove to be fallacious in the end. In the first place, we consider the bank currency entirely safe to the holder as it now is. In the next place to require what you suggest would involve a tie-up of so much of the bank capital, all of which we think ought to be available to the uses of industry and trade."

"Again," he added, "we think general industries and business affairs should be involved to the smallest degree possible with government finances. If we should become engaged in a protracted and exhausting war, the price of our bonds might fall. The value of the securities upon which the safety of the bank note was supposed to rest thus declining, distrust and panic might set in at the most inopportune time—an inopportune time, because it is precisely in time of war that the government must make the severest financial exactions from its people. It is therefore doubly important

that general business should be protected from, rather than exposed to, the perturbations in government finances when the latter are under stress and strain. It is just then that we need the greatest strength and the most steadiness in the personal affairs of our people, for it is from them that we must draw resources and supplies."

"One more question," I urged. "You have, I know, revenues somewhat in excess of expenditures, and necessarily carry a working balance on hand. Where do you keep this cash, in your own strong boxes, as we do?"

"No," he answered, "we are a small country, not rich, like you. If we locked up this money, amounting sometimes to thirty millions of dollars, it would be an economic crime. We deposit our idle funds among the eight banks, and they serve as an important aid to industrial activities, while they are always subject to our call when needed."

It is noticeable that on three particulars—legal tender paper money, bank note issues, and the keeping of the public moneys—we pay no regard to the opposing argument. Nevertheless, the reasons set forth by that finance minister for adhering to a policy so radically at variance with our own are deserving of deep consideration. Having found, as we believe, that legal tender government paper money supplied an imperative need in a time of war, we cannot persuade ourselves to abandon the use when the emergency is passed.

In his country the bank note, while safe to the people, is the most valuable instrument by which the credit of a bank can be made available to the borrower for the uses of industry and commerce. With us the bank note, while a good medium of exchange, is as costly to the borrower as capital, since an investment of capital equal to the bank note itself is a condition precedent to its issue. In his country the moneys taken from the people by taxation are not actually withdrawn from commercial uses; they are merely transferred from public ownership in the payment of public expenditure to the private creditor of the government. With us the proceeds of taxation are entirely withdrawn from commercial uses and held in idle hoard in the public treasury until actually distributed for public expenditures.

Has our government's course been a wise one? Taking the last thirty years, what sum on the average, in excess of an ample working balance, has the treasury kept under lock and key and away from all current use in the fields of industry and exchange? The amount is found to average fifty millions of dollars.

If these surplus millions had been deposited with National banks in the clearing-house cities, in the proportion the relative capital of each bank bears to the whole capital; and if, secondly, the only security to the government had been, in case of bank failures, a prior lien on such bank's assets, not a dollar of loss would the treasury have suffered.

Next, if under these conditions the banks had paid interest to the government at the rate of 2 per centum upon the funds so deposited, how much would the treasury have been benefited? Answer: Thirty-two millions of dollars.

Lastly, with this fund as an aid to their general operations in the field of trade and commerce, to what extent, on the average, would the banks have been able to increase credit accommodations to the people? Answer: Two hundred millions of dollars.

Have we not been guilty of an enormous economic waste by reason of our peculiar Treasury system?

I could pursue into detail the faults with which our financial system may be justly charged. But the matter has been presented over and over until the theme is badly worn. Permit me, however, to summarize into several brief propositions an expression of my own financial convictions.

First: I believe it to be most desirable that the demand liabilities of the government known as legal tender notes should be put in the way of retirement and cancellation.

Second: I believe that this can be accomplished without any burden of interest cost to the public treasury.

Third: I believe that our system of bank note circulation can be and ought to be so modified as to make it more responsive to commercial and industrial requirements, without any increase of risk to the bill holder.

Fourth: I believe that beyond acting as a guardian and trustee for the people in relation to national banks, the government's guaranty to bank note issues should cease.

Fifth: I believe that the public moneys in excess of a reasonable working balance for daily use should be deposited in national banks. That a simple and safe system of distribution of funds can be devised I have no doubt.

Sixth: I believe that in periods of national peace and prosperity the public revenue should be somewhat in excess of public expenditures, and that the surplus revenue should be applied to the reduction of the public debt.

Time will not permit me to support these statements of belief by argument now, and I will leave them to be the subject of your own reflection.

In the beginning of my remarks I expressed the opinion that there is too close an intimacy between the government's finance and our commercial affairs, and appealed to your memory of our history in support of that proposition. It is a comfort and satisfaction to note that at the present moment the injurious effect of such intimacy appears to be at a minimum. The public treasury is strong, the public credit is high, and at the same time the situation of general finance, as represented by banking and commercial interests, is most satisfactory.

I want to close my talk by presenting some facts in comparison, which will at least illustrate the strong and satisfactory condition of the national finances. While British consols drawing 2¾ per cent. per annum are quoted at 92, German Imperial 3 per cent. bonds at 88½, Russian 4s at 102, and French 3s at 102, United States 2 per cent. bonds are quoted at 107, and United States 4 per cent. bonds of 1925 at 138.

It may throw some light upon this comparison so favorable to us if I particularize a little. On April 1, 1898, the interest bearing public debt stood at $847,366,680. Deducting from this the cash then on hand in the treasury, amounting to $226,166,944, leaves $621,199,736. Incidental to the war with Spain bonds were issued to nearly two hundred millions, so that on November 1, 1899, the interest bearing debt had risen to $1,036,049,020, or deducting cash in the treasury amounting to $289,391,540, the debt, less cash, stood at $756,657,480, an increase of $135,457,744 between April 1, 1898, and November 1, 1899.

On August 1, 1901, the interest bearing debt stood at $985,476,-

060; less cash in the treasury, $327,368,877; making debt, less cash, $658,107,183, a reduction of $98,550,297; or having now no regard for the increased cash in the treasury, we find that the face amount of the interest bearing debt, which stood on November 1, 1899, at $1,046,049,020, now stands (August 1) at $985,476,060, a reduction of $60,572,960.

But this is only a partial statement. Concurrently with this reduction of the face of the debt, there has been a reduction almost equally great in the amount of interest which then burdened the future. Of the moneys coming into the treasury during the short period under review, $43,582,005 has been used to settle and discharge interest which would otherwise have been a charge upon the treasury during the next four to eight years. By the use of something more than forty-three millions, interest to the amount of $54,548,424 was settled—the difference of nearly eleven millions being a nominal profit to the treasury.

This operation was, as you all understand, incidental to the refunding of a portion of the public debt into the new 2 per cent. bonds. To summarize briefly: Within two years the principal of the public debt has been reduced by the sum of $60,572,960; the interest has been anticipated and settled to the amount of $54,548,424—a total reduction of $115,121,384; while the annual cost for carrying the debt in the future has been reduced from $40,347,884 annually, where it stood on November 1, 1899, to $29,723,019—a net saving annually of $10,624,865. The cash in the treasury has been increased from $289,000,000 on November 1, 1899, to $327,000,000 on August 1, 1901—a gain of $38,000,000. On November 1, 1899, of the money in the treasury $100,000,000 in gold was regarded as a traditional reserve for the redemption of the legal tender notes. On March 14, 1900, by solemn statute, $150,000,000 was specifically pledged to this purpose and abundant power placed in the hands of the Secretary of the Treasury to restore the amount should it become impaired.

These facts go far to explain the superior credit of the United States in the world's market, as illustrated by quotations on the public bourse. The facts show a condition of unparalleled strength in the public treasury. Nor has this strength been gained by ex-

haustive taxation of individual or corporate resources. Every evidence exists of a general well-being in industry and trade.

Looked at from the standpoint of true statesmanship, it would appear that the present is the most propitious hour in all our history, and as favorable as any period we may hope for in the future, to enter upon reasonable and judicious measures to eliminate all elements of financial weakness which experience has brought to light, and to perfect our now faulty system of currency. We need judicious, careful reform; we do not need revolutionary

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NATURAL BANK CURRENCY AND NATIONAL BANK CURRENCY

ADDRESS DELIVERED BY WILLIAM B. DEAN, OF ST. PAUL, MEMBER OF THE INDIANAPOLIS MONETARY COMMISSION, BEFORE THE MINNESOTA BANKERS' ASSOCIATION, AT DULUTH, JULY 24, 1901.

THE distinction your committee of invitation has conferred upon me may possibly be attributed to my connection with the work of the Monetary Commission of the Indianapolis Convention. May I speak, for a few minutes, of this convention? It was composed of delegates from the commercial bodies of the principal cities in twenty-eight states and territories, representing in its composition the vigorous and intelligent men in whose hands are the commercial activities of our country. For years the business of the nation had been ground between the upper and nether millstone of the gold and silver question. The possible election of Mr. Bryan was regarded as involving the most tremendous and terrible consequences. With silver the standard of value and gold becoming a commodity of merchandise, it was believed that such a financial convulsion would shock the country, in the readjustment that must occur, that ruin and desolation would pervade all its business affairs.

The men who assembled at Indianapolis determined that, if it were possible, an end should be put to all doubt as to the standard of value, by such legislation in Congress as would settle the ques-

tion so far as it could be done by legislative act. The convention ordered the appointment of a Monetary Commission of eleven members, in the event of Congress itself neglecting to appoint one, and this commission was instructed to prepare a plan, the fundamental basis of which should be, first, that the present gold standard should be maintained; second, that steps should be taken to insure the ultimate retirement of all classes of United States notes by a gradual and steady process, and that there should be a separation of the revenue and note-issue departments of the treasury; third, that a banking system should be provided which should furnish credit facilities, and especially with a view of securing such a distribution of the loanable capital of the country as will tend to equalize the rates of interest in all parts thereof.

It was my good fortune to enjoy the honorable distinction of association in this important duty with such men as ex-Senator Edmunds, ex-Secretary of the Treasury Fairchild, Professor Laughlin, of the University of Chicago, Mr. Stuyvesant Fish; the president of the Illinois Central Railroad, and other gentlemen of conspicuous prominence in the localities from which they were chosen. The meetings of the commission were held in the city of Washington, and, after weeks of the most serious consideration of the questions submitted to them, their report was made to a second meeting of the convention, held about a year later in Indianapolis, which was attended by even a larger number of delegates, and of the same sterling character as the first.

The report of the commission was unanimously adopted and commended in the strongest possible terms. An extended report, a volume of five hundred pages, prepared at its direction by Professor Laughlin, of the University of Chicago, embodies the reasons which influenced the commission in reaching its conclusions. As this report is now being used by twenty-five or thirty colleges, among which is Yale College, as a textbook, the value of the services of the Monetary Commission and the correctness of the conclusions presented in its report may be estimated. If I may speak of the work of the members of the commission—and I desire to do so in a manner as wholly impersonal as possible—I can say that the country was never served by any of its citizens who were prompted by higher and more patriotic motives. The only

conclusion sought was one that would best promote and maintain the highest standard of financial truth and honesty. What were its recommendations?

That the existing gold standard should be maintained with the free coinage of gold; no more silver dollars to be coined; the separation of the monetary and fiscal operations of the Treasury; the redemption and cancellation of all government notes, and the payment of all government obligations in gold, including the exchange of gold for silver dollars, and vice versa; prohibiting the issue of any notes in denominations of less than ten dollars, excepting silver certificates. The authority for national banks to establish branches was recommended, and the organization of national banks of $25,000 capital; the gradual change from the present system of issuing bank-notes by government bonds to issues depending for security upon a guaranty fund, contributed by all banks issuing notes, together with the general assets of the banks and the stockholders' liability.

The commission, in its report, made other recommendations of minor importance; yet, all suggesting, as it was believed, an improvement on existing conditions.

Several of the recommendations were adopted by Congress and became law under the act of March, 1900. It is to be regretted that Congress failed to adopt the recommendation for the exchange of silver dollars for gold, to place the gold standard beyond question so far as that could be done by legislative act.

I do not hesitate to declare, without fear of successful contradiction by anyone aware of the facts, that this legislation, imperfect as it may be in some highly desirable respects, would probably not yet have been obtained had it not been for the unceasing exertions of some of the gentlemen who took the most active part in pushing the work of the Indianapolis convention.

In thus recalling to your attention the work of the Monetary Commission, the excellence of its recommendations must commend themselves to your consideration. If any gentleman of the Bankers' Association should be inclined to take issue with any of the conclusions of the commission, it would probably be on the subject which you have invited me to present to you upon this occasion. But upon that may I not claim your favorable presumption, plead-

ing the careful and studious attention which the commission devoted to the study of the question, and its patriotic desire to submit a banking plan conceived to be for the greatest good, not of bankers only, but of the interests of the whole country?

While we are accustomed to look up to bankers as the doctors of finance, from whom is derived our instruction in all that is soundest and best in banking and all matters pertaining to money, still experience has taught us that even with bankers errors in judgment are sometimes found. In a series of questions sent out by the Monetary Commission to about a thousand bankers and others, asking for suggestions on the subjects named, such as the continued coinage of the silver dollars and the retirement of the greenbacks, it was astonishing to find a large number who, in their replies, favored the policy of the government continuing to buy silver and to coin silver dollars, and a larger number, probably, who were opposed to retiring the greenbacks; and yet, to all sound thinkers on these two propositions, it does not seem possible that any difference of opinion, especially among bankers, could possibly exist. The silver dollars with their 50 per cent. fiat, and the greenbacks with their 100 per cent. fiat, have given rise to the most pernicious heresies with which our country has ever been afflicted. The greenback has been glorified as the blood-stained savior of the Union; yet it defrauded the soldier of a large part of his hard-earned pay, added more than a third to the enormous debt with which the Civil War burdened the country—and, worst of all, remained to teach the nation a false notion concerning money, which, in 1893, might have wrecked the Treasury itself.

I believe that a great advance has been made in the financial education of the people within the past few years. Questions that were debatable not long since are now considered settled and beyond the realm of discussion; but believing that much remains to be said on the topic assigned me, I venture to present some thoughts for your consideration.

The title your secretary was pleased to give my subject was, "Asset Currency and National Bank Currency." May I call my subject "Natural Bank Currency and National Bank Currency"? I choose this title, not because of its alliteration, but rather because it more accurately expresses what I shall seek to maintain, that a

natural bank currency is not less, but more, a national currency than that issued by the banks under the present law. The present system of issuing bank-notes was founded primarily in order to make a forced market for United States bonds. The law was derived largely from the free banking system of the states of New York, Ohio, and Michigan, as they existed before 1860. The necessities of the general government at the time of the enactment of the law suggested the use of United States bonds as a basis for the banks to issue currency which would be as safe as government bonds, and at the same time enlarge the demand for the bonds which the government so sorely needed to sell. In order to make the monopoly for the government complete, a 10 per cent. tax was laid upon the issues of state banks, which caused immediate retirement of their notes, and left the field for circulating notes entirely to the new national banks.

It is a remarkable commentary on the system of banks issuing a bond-secured circulation that, when the national bank currency act was proposed, a committee of the bank officers of New York City reported that "it was plain that the act would foster a system of 'wild-cat' banking," showing how vividly the impression remained of the bond-secured currency that had been issued a few years before, under the laws of the states of Illinois, Michigan, Wisconsin, and Minnesota, and which had met disastrous results. To say that the national banking act has many admirable features to commend it, is quite superfluous. Having the national banks in all the states under a uniform law, with issues uniform in appearance, with reports and examinations of the most searching kind, are advantages and safeguards that should never be dispensed with under any banking law or system. But admirable as are many of the provisions of the act, experience shows that in its ability to furnish a banking currency for the country, sufficient for trying emergencies of a commercial panic, it has been a failure. In the year 1866 soon after the act had been generally accepted by the banks all over the country, their notes in circulation amounted to $281,-479,000; the deposits, at the same time, in the banks amounted to $598,077,000. In 1882 the circulation had increased to $358,742,-000, an increase of about 27 per cent., being the highest amount the national banks have ever issued; the deposits at the same time had

increased to $1,138,071,000, or about 90 per cent. more than in 1866. In 1900 the circulation had not only not increased, but was about seventy-five millions less than in 1882, and only about two and one-half millions more than in 1866, notwithstanding a large increase in the number of national banks and an increase in bank deposits to $2,602,100,000, or nearly 336 per cent. over 1866. This showing would seem to indicate either that bank checks and other instruments for the transfer of credits were taking the place of bank-note currency, or that there are fatal obstacles in the way of bank-note issues, which must be removed if the banks are to serve the commercial public with these useful instruments. Is it not proper to inquire whether the issuing of bank currency based upon United States bonds as security may be regarded as a permanent principle? As a patriotic American, believing in the great growth in wealth and strength of our beloved country, I fondly anticipate the happy day when the public debt shall be paid off. Since the Civil War, more than two-thirds of the debt has been paid, and every month we now read of the Secretary using the Treasury surplus in the purchase of bonds, and reducing the debt still more. When the last bond is bought, and the nation has no longer any bills payable, upon what bonds then shall the national banks base the issue of their notes? The question needs no reply; the experience of past years suggests that no bonds can take the place of government bonds. Suppose, however, that our patriotic anticipations be too delusive, and that a public debt is to remain, as with nations of Europe. Is the debt to grow in amount so as to keep pace with the growing business of the country that the demand of the national banks for circulation may be supplied? Even were government bonds to remain abundant, a currency issue upon them is rigid and undesirable. Bank currency, like bank deposits, should owe its origin and its value to the wealth of the country in process of exchange.

But let us dismiss this, and consider the system as it is to-day, in our inquiry for what is best. Is the national-bank circulation a true bank currency? Manifestly not. Experience shows that national bank currency neither increased during periods of greatest activity nor diminished during periods of depression. While all other forms of bank obligations, such as cashier's checks, certifi-

cates of deposits, drafts, and checks followed the alternations of increasing and diminishing commercial demands, bank-note circulation has been but little affected. Indeed, bank-notes issued upon United States bonds as security appear to me to be only a device by which money invested in the bonds may be released and restored to the bank investors, less whatever premiums may be paid for the bonds; the banks receiving interest upon the bonds, and at the same time having all the money invested returned to them, less the small premium the bonds may cost. That is to say, a bank of $100,000 capital, and corresponding deposits, may invest about $106,000 in United States bonds, and within due time receive from the comptroller $100,000 currency, making a permanent investment in the premium of $6,000, and receiving annually interest upon the bonds to the amount of $2,000. It is only the cutting-up of the United States bonds in small amounts, and using them through the banks as part of the circulation of the country. It is apparent that this circulation from its very nature can bear no relation to the business needs of the country. Its volume is fixed by the profit to be made upon bond investment, and not regulated by commercial demand. This is more clearly shown by the very course of the national-bank notes themselves. They are issued as the promissory notes of the banks. They are ostensibly its bills payable, the same as any other of its obligations. But how differently they are treated. Where cashier's checks, certificates, or drafts are paid or redeemed by the bank, the proper account is charged with the amount paid for the redemption, and the instrument is canceled, but with a bank-note—the bank's promise to pay—if it is ever redeemed, is put in the drawer with other cash assets of the bank, and counted as cash. How extraordinary and absurd it would appear to a bank officer if a merchant seeking an accommodation should list among his assets in the statement of his condition a lot of his paid promissory notes! This is not to say that the bank-notes so counted as cash are not good. They have behind them the pledge of the bonds, besides having a paramount lien on the assets of the bank and the liability of the stockholder, but it illustrates the fallacy of calling such issues a currency adapted to the needs of business.

Setting aside the right the bank-notes have of a paramount

lien on all the bank assets and the stockholders' liability, let us in passing inquire as to the certainty of the value of the bonds which are commonly regarded as the chief and great security. When the National Banking Act went into effect, United States bonds were selling for specie very much below their face value. The whole country was in a state of specie suspension, and legal tenders had taken the place of gold and silver, fluctuating in value with the varying operations of the army and navy. Victories, with the probable success of the Union armies, advanced the value of legal tenders, as disasters and defeats depressed them. Since the resumption of specie payments and the settling of the finances of the country again upon a solid foundation, United States bonds have always sold at a most gratifying premium. The conjecture at this time doubtless may be wholly academic, but it is interesting to imagine what would have been the effect upon the banks if the theory had prevailed, advocated a few years ago by so many of the leading men of both political parties, of paying off United States bonds in greenbacks and discharging in this way a matured interest obligation with a demand obligation, bearing no interest. Would the greenbacks then have taken the place of the bonds as security for circulation? If not, what would have been the basis? We live in the happy hope that this dishonest delusion has vanished forever, but when we recall the names of Senators Thurman, Pendleton, Bayard, Beck, Governor Morton, General Butler, and others who contended for the right to pay government bonds in that way, we cannot safely declare that that vagary will never again return to plague us. Suppose the country should be plunged into a war with some of the formidable powers, what then? Suppose, when President Cleveland so chivalrously took up the cause of Venezuela, for which the United States has never enjoyed any gratitude, England had accepted the challenge and with her tremendous navy had blockaded some of our great Atlantic cities, what then would probably have been the price of United States bonds, and the value of circulation based upon them? As the Boer war has reduced the price of British consols from 114 or more to 92 or less, so there can be no doubt our own bonds would have been similarly affected. With our bonds below par and a run upon the Treasury for the payment of legal tenders in gold, would the Treasury again suspend

specie payments as it did so unfortunately, and, as many believe, unnecessarily, during the Civil War; and with suspension, in what would our national-bank notes be redeemed? In legal tenders, or gold.

With United States bonds as security for the redemption of bank-notes, and the bond selling below par, it would seem to be inevitable that a general suspension of specie payments must follow. So close a relation between the perils of government and the general business of the country is surely to be deprecated, and ought not to exist. That it need not exist was clearly illustrated during our Civil War. While the obligations of the government were then selling far below par and the indebtedness of the people of the whole country east of the Rocky Mountains was being paid in depreciated money, the people of California determined that their money operations should be maintained upon a specie basis, and to the lasting honor of their splendid integrity let it be said that they never departed from the gold standard in the payment of their debts. Does this not teach true business independence, and that the government ought to go out of the banking business and have no relation whatever to the banks of the country further than to put in force such regulations as may be necessary to protect the people against fraud and to exercise a wise supervision over the whole system?

The redemption of bank-notes should be in gold only. To redeem the promise of the banks to pay dollars in the promise of the government to pay dollars, is not to redeem in the real dollars themselves. Nothing but redemption in gold dollars should be recognized as the fulfillment of the promise to pay. This satisfaction of one promise to pay with another promise to pay is only another illustration of the noxious influence of the evils of the legal tenders. Indeed, so familiar has become the idea of paper legal-tender money, and so demoralized has become the financial morality of some bankers, that they have advocated making bank-notes themselves a legal tender, and permitting the bank's reserves to be held in these legal tender promises. Is it not time for a clearing of the financial atmosphere, and for all to demand that the government should retire at once and forever these vitiating promises, and again to establish the Treasury and the banks on the solid

foundation of gold coin? Upon no class of citizens does the duty of leading in this righteous movement devolve with the same force as upon the bankers. The imperfection and inadequacy of the National Banking Act is seriously experienced in times of currency stringency. The banks are then utterly powerless to afford needed relief at the most critical period, and at the very time when a natural system would permit them to fulfill one of the chief purposes of their existence.

In the panics of 1860, 1873, 1884, 1890, and 1893, when financial storms were sweeping over the country and business houses were toppling over by the thousand, the currency famine prevented the banks from rendering the aid so sorely needed, and which under a less rigid system would have been so gladly granted. The banks of New York and other large cities saved their reserves and themselves only by issuing clearing-house certificates. These certificates were simply natural currency. They had no bonds for the security of their payment. They were secured only by the assets of the bank, the representatives of the exchangeable wealth of the country. The certificates were without warrant of law, and probably in violation of law, but the emergency that called them forth justified their issue, and the whole country ratified the action of the banks. In various parts of the country, banks, railroad companies, manufacturing concerns, business houses, cities, and counties issued paper that circulated as money, and was accepted by the people with avidity and gratitude. The amount of the certificates issued by the clearing-house in 1893 in the principal cities was upward of seventy millions of dollars.

If, then, there are objections to the national bank currency, to what shall we turn? Let me present for your consideration the alternative of a "natural bank currency." The provisions of the national banking act for the regulation of banks, their critical supervision by a national officer, and the uniformity of note issue should be retained, and no plan dispensing with any of these excellent features should be considered. They must be retained and improved wherever it is possible. To illustrate how a natural currency originates, performs its functions, and then retires, let us take a quite familiar example—one no doubt you already anticipate, and partaking somewhat of the character of a kindergarten example i

banking: Mr. A, a customer of a bank, well known to its officers to be responsible for the amount of a desired loan, proposes to undertake the purchase of some of the products of the country in which he is carrying on his business. For this purpose he offers his note for $10,000 for discount, which is accepted by the bank. The proceeds of the discounted note may be placed to his credit on the books of the bank as a deposit, against which he can check as his needs require, or he may take a cashier's check, or a certificate of deposit, or a draft on some bank conveniently situated. But the nature of his purchases does not permit the use of any of these instruments of credit, and it is necessary that he shall pay the cash as the purchases are made. In order to do this, the bank issues to him its demand promissory notes in convenient denominations, and with these Mr. A proceeds upon his venture. In due time the purchases are all made. The situation then is as follows: The bank has Mr. A's $10,000 note in its assets; his warehouse contains the valuable products the bank's accommodation has enabled him to buy, and the parties from whom they were bought hold the promissory notes of the bank. In the course of business Mr. A disposes of his commodities, and receives for them the money that enables him to pay his note at the bank; at the same time, the bank-notes which he paid out for his purchases find their way back through the channels of business to the bank for redemption, and the bank, having the money with which Mr. A paid his note, is enabled with it in turn to redeem and retire the notes it issued. The whole transaction thus becomes complete. Mr. A has enjoyed the profit which the bank's accommodation has enabled him to make; the bank has received the discount upon the note and the payment for the use of its instruments of credit. No purchase of bonds nor investments foreign to the transaction in order to effect it have been required. Now, as the number of these business operations throughout the country increases or diminishes, so will the volume of the bank issues increase or diminish, accurately reflecting the prevailing business conditions.

It seems to me that, providing the bank-notes issued in this way are certain of being honored when presented for payment, the system of operation I have thus outlined is natural and ideal. For their security they have behind them the liability of the maker of

the discounted note, including the merchandise he has bought with its proceeds, which is a part of the real wealth of the country itself and in its most liquid form. As the Monetary Commission says, in its report referring to such security for bank-notes: "If these resources are insufficient security, they will be insufficient only because there would be such a condition of business paralysis that government, municipal, and railway bonds would be valueless." The Monetary Commission, in its report, however, proposes as further security for the payment of bank-notes that each bank shall deposit with the United States Treasury a redemption fund of 5 per cent. of its outstanding circulation, and in addition the notes to be a first lien on all assets of the bank, including the liability of shareholders. It is an essential requisite of anv system of bank-note circulation that the notes should be absolutely certain of payment when presented to the issuing bank or its redemption agency, and that the notes should circulate with unquestioned confidence everywhere in the land.

It is believed that the plan recommended by the Monetary Commission for the establishment of a guaranty fund will secure these two necessary attributes. The recommendation of the commission for a guaranty fund is not original, but was suggested by the successful experience of banking systems in the states, before the Civil War, and in other countries.

In 1829 the so-called "Bank Fund" was established in the state of New York. This fund was created by an annual tax by the state on each note-issuing bank, of ½ of 1 per cent, of its capital stock, to be accumulated until it was equal to 3 per cent. of the stock. This fund, however, was then intended as a guaranty for both deposits and circulating notes. The act was subsequently modified in some particulars. The fund was in existence eight years before the failure of any bank caused it to be drawn upon. It was not until 1842 that experience proved the inadequacy of the fund for the safety of both notes and deposits, and in that year an act provided that the fund should be used only for the redemption of notes of failed banks. An examination of the facts shows that if the Bank Fund had been made applicable, from the beginning, only to the notes, and the notes made a first lien upon all the bank assets, as they were by the constitution of New York itself in 1846, and

earlier by the state of Connecticut, and with a provision regulating the amount and method of their issue, the Bank Fund would not have been one-half exhausted. The experience of New York under this system, including the speculative years from 1835 to 1839, shows that the total loss from circulating notes, if the system had been established in its finally perfected form, would have been met by an assessment of less than one-tenth of 1 per cent. upon the capital of the issuing banks. Other applications of the principle of the guaranty fund in the United States are to be found in the state-bank sysem of Ohio and Iowa, which appear to have given entire satisfaction. When the plan for a guaranty fund was proposed in the state of New York, in 1829, Mr. Van Buren, then governor of the state, referred it to Mr. Olcott, cashier of the Mechanics' & Farmers' Bank of Albany, for his opinion. He "discovered that cautions and careful banking companies never would consent to make themselves liable for the performance of contracts of the various banks scattered over the great state from Long Island to Lake Erie," and "yet, it is to his skill and sagacity, aided by a few other intelligent and patriotic bankers, that the New York public are indebted for the most perfect system of chartered banking which ever was invented." Hon. Millard Fillmore, afterward President of the United States, and then comptroller of the state of New York, reported, in 1848, that "it is apparent that the safety fund would have proved ample indemnity to the bill-holder, had it not been applied to the payment of other debts of the banks than those due for circulation;" and Mr. L. Carroll Root, an authority on financial questions, states:

As the result of calculation from experience of thirty-six years—from 1829 to 1865—that had the safety fund system been left untouched as that upon which New York state bank currency was based, not merely would every dollar of circulation have been kept good, but the total assessment to keep the fund good would have averaged less than one-fourth of 1 per cent. on the banking capital, or about three-eights per cent. on the average circulation outstanding.

Applying the principle of the guaranty fund to the experience of the national bank circulation, Mr. Conant, a careful writer, says:

The following result has been reached: The average circulation of the national banks from 1864 to 1899 was about $277,000,000. The circulation of the national banks placed in the hands of receivers during this time was $21,328,197. Calculations by Comptroller Dawes showed that the

average dividend of the failed banks on their general liabilities were about 74 per cent. If the $21,328,197 bank-notes had not been secured by bonds, but had shared ratably with the general liabilities, the proportion of the note issues that would have fallen as a loss on the guaranty fund would have been about $5,000,000, or an annual average of $158,000 for the thirty-five years from 1864 to 1899. A tax of one-half of 1 per cent. upon the average circulation for this time would have brought into the fund $1,385,000 per year, or about eight times the average annual loss. The total collections for the thirty-five years would have created a fund of nearly $49,000,000; deducting the computed loss for the same period, a remainder of nearly $43,000,000 would have been left in the fund.

An average tax of one-fifth of 1 per cent. on the total circulation for thirty years would have covered all the notes of all the failed banks.

Statistics like these are an unanswerable argument for the absolute protection such a guaranty fund would afford to circulating notes, and the inviting profit the banks would enjoy, through the privilege of such issues, warrants their acceptance of such a system.

The system to-day is in most satisfactory operation in the Dominion of Canada. Its success there invites the thorough study of all intelligent bankers. The experience of the bankers and the people of Canada, both the lenders and borrowers of money, should commend this natural and independent method of banking as well worthy of the adoption and confidence of the commercial world.

The objection frequently expressed to making the notes a first lien on the assets of the bank and upon the stockholders' liability, in my opinion, is not well founded. It is the provision of the present national banking act, and while the guaranty fund suggested is abundantly ample to protect the notes, yet, in order to give them the widest circulation and to secure the most implicit confidence of the people, this provision, so long existing as a part of the system, should continue to be maintained. Besides, as a question of equity, it seems clear to me that bank-notes in the hands of involuntary holders, as they must be in the course of promiscuous circulation, should stand in a different relation to the assets of the banks from the deposits of creditors who have voluntarily made the banks their debtor.

The recommendation of the Monetary Commission does not make it obligatory upon all banks in the system to issue notes and become contributors to the guaranty fund. The privilege of issuing

notes is made entirely voluntary. If the officers of any bank believe it unadvisable for any reason to issue circulation, there is no compulsion to do so. The bank may be continued without circulation as is the case with many of the national banks under the present system. A writer of distinction has well said:

> The issue of bank-notes upon business assets is the natural and scientific theory of banking, because the circulating medium is the instrument of business transactions, and should be developed out of them and governed by them. A system of note issues upon business assets is self-regulating, under requirements for prompt redemption in gold, because the notes promptly return to the issuing bank for retirement when the quantity in circulation becomes excessive.

If, then, it can be shown that banks may issue their circulating notes, based upon a guaranty fund, making them certain of payment and of universal acceptance, why should not such a plan be adopted? The connection between the banks and the government, excepting supervision, would be at an end. It would then make no difference to the banks, so far as circulation is concerned, whether government bonds were paid off or not; or whether they were paid in greenbacks, silver, or gold; neither would the circulation be affected by the political operations of the government, nor the market price of bonds. The business activities of the country would have free play, and their expansion and contraction would be faithfully assisted and reflected in the business of the banks, irrespective of government operations.

The State Bank of Indiana, and its branches, with Hugh McCullough as president, is a towering monument of the most successful banking. From 1834 to 1866 it prospered and brought ample rewards to its stockholders, and through its wise policy contributed greatly to the development of the state of Indiana. "In the panic which came in the autumn of 1857," says Mr. McCullough, "all the eastern banks, except the Chemical of New York, and all the western banks, except the Kentucky banks and the Bank of the State of Indiana, suspended specie payment."

The banks of New England, under the Suffolk Bank system, afford a most notable illustration of the application of right banking principles to circulation. Under an arrangement entered into between the banks in the New England states and the Suffolk Bank of Boston, it became what we may term a general comptroller for

them all. It held an agreed sum from each as a guaranty fund, and in consideration redeemed their notes in Boston in specie, charging each bank with its redeemed notes, and returning them at stated intervals. Under this system of redemption it was impossible for the banks to force an unnatural and undue amount of notes into circulation. The result was that the whole volume of the notes of the New England banks was redeemed eight times in a year, whereas the volume of national bank notes is now redeemed about once in every two years.

Considering how deficient the state laws were in many respects before the establishment of the national system in regard to supervision and regulation of banks and of their note issue, the management of the state banks of Ohio, Indiana, Kentucky, and others commends itself to our admiration.

Usually when anything is proposed for the security of bank-note circulation, excepting United States bonds, the cry is raised at once of "wild-cat" banking, as though in abandoning a bond-secured circulation all protection and safeguards were lost. Since the "wild-cat" days, banking, like everything else, has gone through a process in many respects of great development. National regulation and supervision have been established; railroads and telegraphs have made the remotest parts of the country immediately accessible; the scrutiny of banks of each other is more careful and critical, and the methods of business are more exact, so that it would not be possible for many of the banking conditions that prevailed before the Civil War to flourish again. But there were banks in the country, as already shown, even in the so-called "wild-cat" days before the Civil War, whose history remains to teach us of the wisdom, the ability, and the honesty of their managers. All wisdom and ability and honesty necessary for successful bank management were not born with this generation, and will probably not die with it.

The worst, the most disastrous illustrations of "wild-cat" banking were under the laws of states where the circulating notes were secured by the deposit of state bonds and stocks. Many of the older persons present to-day doubtless remember, possibly with sorrow and certainly with shame, the experience we had in our own state of Minnesota with banking on our state bonds as security for circulation. Only loss and dishonor remain of that unfortunate era.

The same woeful tale of disaster and loss was experienced with the bond-secured banks of the states of Michigan, Indiana, Illinois, and Wisconsin. It was the recollection of the fate of the system in these states that led the New York bankers to look with suspicion upon its introduction into the National Bank Act when it was proposed.

The policy of issuing circulating notes based on business assets has been that of the leading banks of foreign countries for many years. The Bank of England may be considered an exception. The notes of the issuing department of that bank are fixed in amount by the act of 1844, and secured in part by a pledge of the public debt, and coin for all amounts exceeding this sum of debt. But this exception only seems to prove the rule; for, in the panics of 1847, 1857, 1866, and 1890, the bank had no legal means of increasing its issue of notes. The only way in those crises of averting certain ruin to all financial interests was by transferring to the issue department an amount of its government securities and obtaining an issue of notes against them, which then enabled the bank to discount commercial paper and relieve the tension. This violation of the act of 1844 by the bank was condoned and justified by the government on each occasion.

The Bank of France—a creation of the great Napoleon—the Bank of Austria, the Imperial Bank of Germany, the Austro-Hungarian Bank, the Bank of Belgium, the Bank of the Netherlands, the Bank of Scotland, the Canadian banks, and many others, all issue their circulating notes upon their business assets. The issues of some of these banks are qualified by law by a specie reserve, notably the German bank—a provision found in many of the state acts before the war, and in the national act, as originally passed.

It is no reply to the argument drawn from the successful history of the banks referred to, to say that the conditions in the United States are different from those of other countries, and do not admit of the application of the same principles. To that may be said that economic and financial principles are as invariable and universal as the law of gravity. Principles and methods are applicable, without exception, to all civilized commercial conditions, and, in my opinion, to no place more than our own country.

In closing this paper, will you indulge me while I seek to repre-

sent very briefly the influence of the sub-treasury upon the currency question; for there can be no consideration of the question that does not take the United States Treasury into account.

If the Treasury were conducted as that part of a business organization is used in ordinary commercial affairs—simply to receive the funds due the government, to deposit them in banks, and check them out in payment of indebtedness and current expenses—it would require no more attention in considering financial questions than does the Treasury of the Standard Oil Company, the United States Steel Company, the Pennsylvania Railroad, or any other of the huge business undertakings with which we are so familiar in these later days. That the government does not do so cannot be because of the magnitude of its business; for the operations of some of the largest corporations named very closely approach those of the government itself.

During the administration of President Polk, in 1846, the subtreasury was established. It is not now necessary to discuss the reasons why this was done. Since that time all the money of the government received from customs and loans has been kept in the vaults of the Treasury Department. Other receipts, such as excises, taxes, etc., have been deposited in national banks, with United States bonds as security, and have been subject to check and draft, the same as any commercial deposit.

The withdrawal of a large part of the people's money and its retention by the Treasury, apart from the current money of the country, deprives the people of its use, and is often more or less disturbing to business. The evil of the practice is so well recognized by Congress that it has been made a punishable offense by statute to lock up money, and to do just what the law requires the Treasurer to do under the Subtreasury Act.

The subtreasury system is a revival of primeval times, when the money of the sovereign was kept for safety in his own chest. No other civilized nation in the world treats the money it collects from its people in this way. All other governments deposit their funds in the banks of the country, where they are subject to the use of business, just as the money of any of their citizens.

If the principle is right, and the only way for government money to be kept safely is to lock it up, as the Subtreasury Act requires,

why should any money be deposited in banks? Let the state of Minnesota do as the United States does, and instead of depositing its cash on hand in the various banks of the state, as it now does, lock it up securely in its own vaults in the state capitol; let every county and city in the state do the same thing, and every railroad and business house build its burglar and fire-proof vaults and lock up their funds. If the government is right, why should anyone deposit in banks? If the government itself is so distrustful, why should anyone have confidence in the banks? The absurdity of the whole proceeding is too apparent. Such a policy would be destructive of all business, and commerce would come to a standstill, if generally adopted.

If the sum shown by the last Treasury statement to be in the subtreasury was all deposited in the banks, under proper safeguards, and used by the banks as other deposits, the loaning ability of the banks would be increased hundreds of millions of dollars, estimated upon the average reserve of the banks throughout the country.

In striving, then, to devise a system of note circulation that shall be safe, flexible, and universally acceptable, the whole system of government financiering ought to be revised and corrected. The independent Treasury should be abolished; a plan then adopted that will not permit the treasury to withdraw hundreds of millions of dollars from the channels of trade, and when an accumulating balance is to be disposed of—either by the buying of bonds or "in relieving the market"—to subject the whole financial situation to the judgment of the Secretary, whose action may most profoundly affect the business interests of the whole country.

THE MEDIUM OF EXCHANGE AND THE BANKING FUNCTION

ADDRESS DELIVERED BY A. B. STICKNEY, PRESIDENT OF THE CHICAGO GREAT WESTERN RAILWAY COMPANY, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT MILWAUKEE IN OCTOBER, 1901.

THE medium of exchange is an essential part of commerce as distinguished from barter. The ultimate purpose of all commerce is—to use the unique and rather satisfactory expression of the

present Secretary of the Treasury—"to exchange things for things." When "things" are exchanged for money, the process is only half done. Whatever is willingly accepted to represent "things" during the process of the suspended exchange is a medium of exchange.

The usual statement that money is the medium of exchange is but a fraction of the fact. The word "money" is constantly misused. In common parlance, money is synonymous with wealth and capital. It is said of certain men that they have "lots of money," meaning that they possess great wealth; again, that certain merchants have "large amounts of money," meaning that they have large capital; while the fact is that rich men and great merchants have very little money. It is probably no exaggeration to say that the average poor man possesses more *money* than the average rich man.

But it may be said that this is a mere play upon words—that the rich men do not carry their *money* in their pockets, but have *money* on deposit in banks. This proposition presents another popular misuse of the word "money." No man has money in the bank. A credit on a bank ledger is not *money*—it is simply an evidence of the bank's indebtedness, which may or may not be redeemed, like any other indebtedness. Whatever money a bank may possess (which is always less than its deposits) belongs to the bank.

The most which can be said about money as a medium of exchange is that it *may* be used as such; but, as a matter of fact, it is seldom, practically never, used as a medium of exchange except in petty transactions.

Stating the fact affirmatively, the medium of exchange in some petty transactions is money, and in many petty, and in all the larger, transactions it is *credit.* Legitimate credits for use as a medium of exchange are produced by buying for the purpose of selling, and they are extinguished by buying for the purpose of consumption. In short, their creation has reference to production, and their extinction to consumption. Such credits expand as production and commerce expand, and contract as production and commerce contract. The merchant who creates a credit deposits it in his bank and uses it first; then it is transferred by check time after time, effecting exchange after exchange, until it is finally redeemed. The intermediate exchanges are said to be made with cash. Therefore,

while it is true that all the larger transactions of commerce are effected with credit as the medium of exchange, it does not follow that all merchants go in debt for their purchases. The few merchants who do not go in debt use credits which have been created by others.

The modern commercial bank is a most useful institution, but it has no independent function. It is a co-worker with the merchant. The merchant function is primary—the bank function is secondary. Trading is the foundation, and without the trader there could be no banking function. The merchant creates the credit—the bank fructifies it and makes it available as a medium of exchange. The bank is also the clearing-house of traders. It clears the trades of its customers by offsetting indebtedness, using but very little money.

The bank is a credit, instead of a money, institution. It deals in credits. The bulk of its assets consists of evidences of indebtedness, and the bank is itself the largest debtor, relative to its capital, in the business world. In short, everybody owes the bank, and the bank owes everybody, and there is little about the bank or its function which does not smack of indebtedness.

There are many misconceptions of the banking function, growing out of the technical but unnatural meaning which, in banking parlance, is given to the words "deposit" and "borrow." When the public is told that the bank deposits have increased a billion and five hundred million of dollars since the panic, it is regarded as evidence of an enormous increase of money. But in fact it means little more than that the conditions of trade are such that merchants have increased their indebtedness, which indebtedness has been exchanged for bank credits, and by this means the indebtedness of the banks has been increased. It is an increase of indebtedness which is available as a medium of exchange, instead of an increase of money. There has been but a comparatively slight increase of money. During the period in which the so-called deposits of the national banks have increased $1,500,000,000, the *money* in the banks has increased only $207,000,000.

Regarding the banks as money institutions, in connection with the use of the words "deposit" and "borrowing," confuses the mind as to the real nature of the so-called deposits and borrowings. It is the general understanding that the sequence of the banking busi-

ness is first a deposit, then a loan, and therefore the bank's so-called loans are limited by the amount of the so-called deposits.

Let us examine these apparently self-evident, but, in fact, false propositions, in connection with an ordinary so-called borrowing. Suppose I borrow in the usual way $100,000 from a bank. The transaction would increase the bank's deposits $100,000, not before, but at the same instant of the loaning, and although it would increase the bank's deposits $100,000, it would be no evidence of an increase of wealth in the form of money or otherwise.

After I had borrowed the $100,000, the bank would have no less money and I should have no more money. I should have only a credit of $100,000 on the bank ledger. It was not a borrowing of money, but a swapping of credits. I have traded my note as evidence of my indebtedness to the bank, in exchange for a book entry as evidence of the bank's indebtedness to me. It is true I may transfer the indebtedness of the bank by check (which is miscalled drawing the money from the bank), but in that case my check will be deposited in the same or some other bank, and that $100,000 note would remain a part of the so-called deposits of the banks, either in the original or in some other bank, until it was finally redeemed.

In this case the bank increased its deposits by increasing its loans, and if the deposits of all the banks be considered as a whole, it will be found that the deposits increase when the loans increase. The deposits, in the main, are produced by the so-called loans.

The fact is that in most of the bank transactions there is no borrowing, or lending, or depositing. They are simply credit transactions, a swapping of credits, which in the matter of bookkeeping increases both the so-called deposits and the so-called loans in the same amount and at the same time. Practically all the so-called deposits are made by swapping the bank's credit for other credits, in the form of promissory notes, checks, drafts, etc. There are small streams of money flowing in and out, but the incomings and outgoings are so nearly equal that a writer has said: "A bank's cash resembles a column of gold with a slight ripple on the surface."

In this country the greatest ripple on the surface of the reserve is produced by the daily clearances. With a properly organized system of banking no money whatever would be required. The

daily balances at the London Clearing House are settled without the use of a penny of money.

Swapping credits is the function of the modern commercial bank. Its business consists in scrutinizing individual credits and in giving its own credit in exchange for such individual credits as are acceptable, and thus furnishing an abundant supply of the medium of exchange of commerce. To regard the bank as a mere money-lender is to belittle its important and useful function.

In this connection I want to say that I like the word "swapping," because it expresses my exact meaning, and even boys know what it means. The boys swap jack-knives and swap marbles. The banks swap credits.

Having stated, as clearly as my ability permits, the nature of the banking function, I shall now venture to speak of some of the difficulties, owing to the restriction of the laws, of a proper exercise of the banking function during commercial crises. To present my propositions clearly, I must repeat that the creation of commercial credits has relation to production, and their extinction to consumption, and there is always a lapse of time between production and consumption. As consumption cannot be unnaturally accelerated, and as the medium of exchange once issued cannot be ultimately redeemed until products are demanded for consumption, a vast volume of such currency must be always outstanding, and as production and consumption are continuous processes, the function of the bank is also continuous.

The bank, therefore, which fails continuously to exercise its function of swapping credits fails to perform its part and its duty, and does incalculable mischief, because the *normal value* of products can be maintained only by the merchants, with the assistance of the banks, carrying them with a steady hand until they are required for consumption.

When the banks, from whatever cause, refuse to perform their part by refusing to swap credits with the merchants, the merchants are compelled to stop buying and vainly to attempt to force their stocks upon the consumers by lowering prices. Such attempts must always be futile, because the consumption which produces the ultimate redemption of credits is necessarily a uniform hand-to-mouth process. The merchants who do it early may unload upon

less foreseeing merchants, but passing merchandise from one merchant to another does not reduce the volume of credits. It only affects the individual merchant, and perhaps his individual bank, by transferring the burdens to other merchants and other banks. But the futile attempts once commenced in a large way force values lower and lower, until some of the merchants and producers are ruined. When some of the merchants and producers are thus ruined, some of the laborers are deprived of employment. When some of the laborers are unemployed, their ability to consume is curtailed, which still further reduces the demand, which still further reduces values, ruins still other merchants and producers, deprives more laborers of employment, which still further reduces consumption and values, and ruins still other merchants and producers, and finally ruins many of the banks themselves.

Probably a majority of bank managers, who have not given the subject special consideration, believe that the withdrawal of balances by customers compels the banks to restrict their loaning during commercial crises, and that many withdraw money which they keep in safe-deposit vaults. While it is a well-known fact that a few withdraw money from the banks in times of panic for the purpose of holding it in their own possession, an examination of the accounts of the national banks, as compiled by the Comptroller of the Currency, is convincing that in the panic of 1893 such withdrawals were inconsiderable; in fact, less than the hard times forced out of the pocket money of the people into the banks. Otherwise, at the pinch of the panic, there would have been less money in the banks than before the panic commenced. But the Comptroller's statistics show the astonishing fact that at the pinch of the panic, when the so-called deposits had decreased $314,000,000 and had reached their lowest point, the national banks possessed $26,000,000 more money than in 1892, when business was brisk and the banks were swapping credits more freely than ever before. This would seem to prove that, whatever may have been the cause of the panic, it was not a shortage of money in the banks, and that it is a mistake to suppose that the difficulties of the banks during the panic years were due to withdrawals of money for the purpose of hoarding. The enormous decrease in so-called deposits was about equal to the decrease of the so-called loans, and was due to the refusal of the banks to con-

tinue swapping credits. The difference between the decrease of deposits and the decrease of loans was only $13,000,000—less than 4 per cent.

While I am prepared to repeat and stand by the statement that the reason of the enormous contraction of the available medium of exchange—or, in other words, the enormous decrease in so-called deposits and the consequent destruction of normal values, followed by bankruptcy of merchants and distress of the unemployed—was the action of the banks in contracting their so-called loans, I am not prepared to say that it was the fault of the banks or their managers. That the American bank, as at present organized, should falter at every minor commercial crisis, and stop, as far as possible, the swapping of credits in a major panic, seems inevitable. The necessity is due to the lack of a banking system.

The American system of banking is often talked about; but, in fact, there is no system. The dictionary defines the word "system" as meaning "a whole plan or scheme consisting of many parts connected in such a manner as to create a chain of mutual dependencies and supports." The banks of this country are not parts of a whole plan connected in such a manner as to create a chain of mutual supports, but they are local and independent institutions. In times of commercial crises each must depend upon itself, and as it is evident that one bank, without the co-operation of the other banks, cannot support the enormous credits of a commercial nation like the United States, each begins to scramble to increase its cash reserve at the expense of the other banks—for where else is the cash to come from? —and to reduce its liabilities. Its isolated weakness compels each bank to prey upon the other banks, and, to adopt David Harum's version of the Golden Rule, "do unto the other banks what you know they will do unto you, but do it fust." This unseemly scramble after money to maintain reserves is never witnessed in any other commercial nation, because all commercial nations except the United States have systems of banks so connected that each bank constitutes a mutual support to each other bank. Practically all commercial nations except the United States have adopted the Scotch system of branch banks, with a connecting link—a central bank—which is the bank of the banks and holds the reserves of all.

In England, where this system of banking has been most highly

developed, the Bank of England holds the gold reserve of all th banks, and of the nation itself. The reserves of the other banks ar credits at the Bank of England. Under this system, instead of al the banks scrambling and competing with each other for the mone to maintain their individual reserves, the Bank of England alon does the scrambling with no competition. Under this system, gol which is withdrawn from any bank is obtained from the Bank o England, and, after circulating for a short time in domesti exchanges, is returned in the ordinary course of business, throug the same or some other bank, to the vaults of the Bank of Englanc Therefore, practically the sole leakage of reserve is for exportatio when the conditions of foreign exchanges are adverse. The dut of managing the foreign exchanges is delegated solely to the Banl of England. England has no treasury—no nation except th United States has a treasury.

If you examine the statements of the various banks of England outside of the statement of the Bank of England, you will not finc among their liabilities any "indebtedness to other banks," whick constitutes about one-half of the liabilities of the banks in the reserve cities of this country, for the reason that their country cor-respondents are but branches of their own bank. This eliminates one of the most dangerous features of American banking in times of extreme panics.

Such systems of banks can exercise, and have for more thar half a century exercised, the function of swapping credits with thei customers in panics the same as in booms. The repression exercise by the banks during commercial crises is effected through the inter-est rate. It was this system which enabled the banks in London, a the time of the Barings' failure—the largest single commercial fail-ure known to history—not only to continue the exercise of th banking function, but to increase their liabilities $125,000,000 b assuming the liabilities of the Barings. In London the bank rate advanced to 6 per cent. for a few days—in New York the outsid rate advanced to 68 per cent. and the banks quit business alto-gether.

Now, it is interesting to inquire as to the banking laws unde which these systems are organized. I have been unable to lear that there are any laws in England or Scotland especially relatin

to banks, except the laws restricting the issue of bank-notes. In all respects the banks are as free as the merchants. Banking corporations are organized under the same general acts as mercantile, manufacturing, and other corporations. The American laws require a certain minimum percentage of reserve, and compel the banks, when that percentage is reached, to do the very thing which banks should never do, viz., arbitrarily suspend the exercise of the banking function. This provision of the law was intended to be a safeguard, but upon several occasions the observance of the law would have brought ruin upon all the banks. On these occasions the New York City banks have boldly disregarded the law in respect to the reserve, and, in defiance of the law, have stood together for a few days as a system.

There is no English law requiring any reserve whatever to be held against so-called deposits. But the Bank Act of 1844, passed with great public favor, names a minimum of reserve to be held by the Bank of England against its outstanding notes. This minimum-reserve requirement was expected to correct everything which was wrong, and especially it was forever to prevent speculations, bank failures, and panics. Like the American law, it required the bank, whenever that limit was reached, to stop discounting.

But history says that within three years the law, instead of preventing, produced every economic disturbance which it was expected to prevent, including a currency panic. The legal minimum of the reserve was reached, and, in obedience to the law, the bank stopped swapping credits, and merchants who had received loans were called upon to pay, without being permitted to renew them. The greatest distress followed. Merchants could pay the loans only by selling their merchandise. London merchants are said to have walked the streets at midnight, offering their goods at any price. Values disappeared. Consols and exchequer bills were offered at enormous discounts, but could not be sold. The most extravagant rates were offered in vain for the use of money.

Finally, in the midst of universal distress, on petitions signed by tens of thousands, the very ministry which had procured the passage of the law was compelled to ask the bank to disregard the law. The bank resumed swapping credits, and history recites that "in ten minutes after it was known the panic was ended." Merchants who had

been clamoring for discounts, as soon as they could get them did not need them, and the smart ones, who had borrowed early and withdrawn actual money, brought back the gold which they never needed and begged to be relieved from the payment of interest. An instance is recited of one firm returning two million pounds sterling ($10,000,000) gold, which it, foreseeing the inevitable, had borrowed early, and begging the bank to relieve it from the further payment of 9 per cent. interest.

Again, in the panic of 1857 the same history was repeated, except that the Ministry refused to act until the total gold reserve in the Bank of England and its branches was reduced to only 358,208 pounds sterling—a trifle over $1,700,000. This was practically the total aggregate reserve of all the banks of England at the close of business November 12, 1857. I ask you, gentlemen, to think for a moment what it would mean in this country if the aggregate reserve of all the banks and the United States Treasury was reduced to $1,700,000! Starting with a total reserve of only $1,700,000 on the night of November 12 (the day the permission was given to disregard the law), the bank made new loans—that is, swapped credits—besides renewals, in the sixteen remaining days of November, amounting to $36,000,000. That is to say, with only $1,700,000 reserve, the Bank of England expanded its loans in eighteen days $36,000,000, and its reserve increased day by day! Following the example, the other banks expanded their credits.

Here are facts well worth your consideration: *When the bank stopped loaning, in order to protect the reserve, the reserve decreased; as soon as it resumed loaning, the reserve increased.*

A writer says:

> This great crisis of 1857, far exceeding in intensity that of 1847, added another proof upon proof that, in a great commercial crisis, the restrictive practice will bring about universal failure of merchants and bankers, and that the expansive practice is the only one which can save both.

Before making further citations of history, I desire to recur to the conditions which prevailed in the panic of 1893. As I have said, the medium of exchange was reduced by the action of the national banks in refusing to swap credits, to the extent of more than three hundred millions of dollars. There is no way to tell how great a reduction was produced by the action of the state banks and the

trust and other companies which exercise the functions of commercial banks. If their reduction was the same as that of the national banks (and there is some evidence that this estimate would be correct), the aggregate reduction of the medium of exchange was the enormous amount of six hundred millions of dollars. This produced an apparent shortage of money to the same extent.

Now, gentlemen, if I were to mention the classes of property which have intrinsic value, and which by reason of their prime necessity should naturally maintain fairly uniform and normal values, I should name the homes, which give shelter; the farms, which produce food and clothing; the manufacturing plants and the warehouses and buildings necessary for trade. But it is a notorious fact that these classes of property had practically no market value during the panic, and that every man who had all his savings invested in equities in such properties, no matter how large the equity, was ruined. I should also name the products of the farms—the food, the cotton, and the wool—and the products of the factories, as property entitled to maintain a fairly uniform and normal valuation, approximately equal to, or exceeding, the cost of production. But if I were asked to name the commodity of the most obvious intrinsic value, I should name labor, because it is the basis of all wealth. Yet, during the panic, the market value of the products of the farms and the factories was abnormally low, and it was estimated that there were more than two million laborers in the United States who were unable to sell their labor at any price, and millions more who were compelled to sell their labor at a reduced price.

The commonly accepted explanation of these phenomena is that market values are governed by the relation of supply to demand, and that the panic had been preceded by activity in production to such an extent that there was over-production. It is my contention that the extraordinary relation of supply to demand was not due to over-production, but to under-consumption. There was not a minute during the panic in which all the homes of this country would not have been in demand for occupation, and there was no time during the panic in which the products of the farm and of the factories would not have had their normal consumption, if all the consumers of the country had possessed the means of obtaining them. *The two million laborers who tramped the country, clothed*

in rags and with insufficient food, had capacity to consume every thing their labor would have produced, had the captains of industry been in position to set them to work, and thus the normal equilibrium between supply and demand would have been maintained.

The reason why the captains of industry were not in position to set these laborers to work was apparently the lack of money, but, in fact, it was the shortage of six hundred millions of the medium of exchange, resulting from the banks' unduly restricting the function of swapping credits.

There are no classes of the people so much interested in the introduction of a system of banking which has capacity continuously to exercise the banking function, as the debtors and laborers.

These are prosperous days. The conditions of trade are such that the merchants and banks have expanded their liabilities beyond all precedents. It is a period of confidence, in which everything goes, and there is no lack of the medium of exchange. But I warn you not to believe that the country has grown so rich that there will never be another period of distrust. Substantial wealth is created by the slow processes of industry, combined with skill and the use of capital. Bubble wealth is created by the rapid process of placing one piece of paper in the possession of a trust company as collateral security for two pieces of paper. Some of the enormous quantity of bubble wealth which is now being created will sooner or later collapse. Such collapse should affect nobody but the bubblers. But without a system of banks which can sustain legitimate credits, there will follow a panic which will again destroy the market value of intrinsic values, ruin debtors, deprive laborers of employment, and create general distress.

Would that I had the ability to arouse the American people to the importance of a banking system! In panic after panic they have suffered, but their minds seem to be possessed with the fatalism of the Turk—"it is the will of Allah!" But I say it is not the will of God which produces panics. History abundantly proves that such panics as occurred in this country in 1837, 1857, 1873, and 1893 are preventable by a known system of banking.

This system of banking originated in Scotland, separated by only an imaginary line from the then independent and isolated banks of England. The superiority of the system was demonstrated through

commercial crisis after crisis, in all of which the Scotch banks remained solvent and continued the exercise of the banking function, while the independent banks of England suspended the banking function and fell like rows of bricks.

In 1825 a parliamentary commission developed the fact that in the panic of 1793 upward of a hundred English country banks had failed. In seven years, 1810 to 1817, six hundred failed, and in the panic of 1825, up to the date of the inquiry, twenty-six failures had taken place. The banks which failed paid but a small percentage of their indebtedness. Before the same commission Mr. Gilchrist, a manager of one of the Scotch banks, testified that within his recollection only one Scotch bank had failed, and it immediately paid fourteen shillings on the pound, and ultimately paid all its liabilities.

The superiority of the system having been thus proven, by a gradual process of amalgamation of independent banks, the system was introduced into England, and the superiority of the system over the want of system in the United States has since been demonstrated.

In the great panic of 1837-38 more than a thousand banks, practically all the banks in the United States, failed. In England and Scotland not a bank failed. In 1856 nearly every bank in the United States closed its doors and went out of business, and but few of them ever resumed. There was a great commercial crisis in Great Britain, but not a bank in England or Scotland failed. Again in 1873 a great many banks in the United States failed, but there were no bank failures in Great Britain, except the City of Glasgow Bank, which had been practicing fraudulent methods for years.

In the panics of 1890-93, which are now fresh in the memory, when bank after bank failed in the United States, and all the banks in New York City suspended payments and only certified their customers' checks, there was not a bank failure in Great Britain. And more, there was not a day when any bank in Great Britain refused to extend its usual credits without unusual restrictions; except for about a week in 1890, at the time of the Barings' failure, when they put the brake on to the extent of raising the rate of interest to 6 per cent.

This system has been adopted by the countries of continental Europe. The United States is the only nation in the world, of

commercial importance, which has not adopted it. It is a remarkable fact that during the last panic, while the commercial crisis was universal, there were no bank panics except in the United States. In no other country was the commercial crisis continued so long, and in no other country did the people distrust the solvency of their banks, and in no other country were there bank failures.

But it may be objected that the situation is different in a vast area of sparsely settled country like the United States. In reply I will say that along our northern boundary stretches a country from ocean to ocean, much more sparsely settled than the United States. Canada possesses a system of banks. In Canada the same commercial conditions existed during the last panic as in the United States, but only two unimportant banks of the isolated and independent order went into liquidation, and not one of their systems of banks excited suspicion as to its solvency, and at no time during the panic did any of them suspend the banking function of swapping credits with customers.

In 1893, 1894, and 1895, when the great banks of New York City dared not extend their credits a cent, the Canadian banks advanced millions to move the wheat crops of my own state of Minnesota and the state of Dakota. Little Canada, with scarcely five millions of people, occupying the stingy fringe of perpetual ice, with meager agricultural resources, few mines, and only rich in her forests of timber, was able to loan the credits to move the abundant harvests of Minnesota and Dakota, solely by reason of her system of banking.

It would seem that nothing short of a special act of Providence would enable our lawmakers to investigate the banking problem free from that political bias which is an inheritance from a squabble between the Democratic and Whig parties over a petty appointment in the Portsmouth, New Hampshire, branch of the Bank of the United States. The only question involved at the outset of the squabble was whether the bank or the Democratic politicians of New Hampshire should appoint the petty officials of the bank. But Andrew Jackson and the Democratic party cunningly magnified it, in the minds of the people, into a contest to "preserve the liberties of the people against the encroachments of the money power." And from that day to the present time the legislation of Congress has

been based upon the supposed necessity of making the banks inefficient in order to preserve the liberties of the people.

A banking system for a great nation like the United States requires a central bank, with a head in the chief commercial city, with branches in each of the commercial centers, which shall constitute the head and the backbone of the system. This central bank should be the bank of the banks, and the bank of the government. The subtreasuries should be abolished. The central bank should hold the gold reserve of all the banks and of the nation. The reserves of the other banks should consist of credits on the ledger of the central bank. Sub-systems should be formed, consisting of heads in important commercial centers, with branches scattered over the country, thus carrying the facilities of great, strong, solvent banks to every hamlet and crossroad in the country.

The only legislation required is the repeal of the subtreasury laws, and of the provisions of the present National Bank Law which in any manner restrict the business of swapping credits, and which prevent banks from conducting the banking function in more than one locality. It would not be necessary, or indeed desirable, to grant the central bank a special charter, with or without special privileges. The banking business is a part of commerce, and commerce is an individual, not a governmental, function. The commercial bank is a co-worker with the merchant, and in the conduct of its legitimate business of swapping credits should be as free as the merchant. Grant the banking business this freedom, and the system, including the central bank, will form itself along the lines of the economic laws to which alone commerce by right owes allegiance.

Such a system, history conclusively proves, has the capacity to continue exercising the banking function, *and thereby sustaining normal values, during the fiercest commercial crises.* A system having such a capacity, in connection with the genius for trade possessed by the people of the United States, and the wealth of its natural resources, may make New York, instead of London, the chief exchange city of the world, and the United States, instead of England, the creditor nation of the world; without it, *never.*

The creditor-nation fact is not altogether a matter of superior wealth or capital. England is the creditor nation, but it may well

be doubted whether she has as much wealth or capital as the United States. It is a matter of organization of capital. Let me illustrate: If I have $1,000,000 of capital, as an individual I can loan only $1,000,000. But if I organize a banking business with my capital and exercise the banking function of swapping credits, I may collect interest on many millions, just as some of your banks with a million of capital loan five, ten, twenty, and even more millions. England has so organized her capital by means of her magnificent banking system that she is the banker of the world and collects tribute from all the nations of the world in the form of interest, not for the use of her wealth or capital, but for the use of her credit. Paradoxical as it may sound, it is literally true that by means of her splendid banking organization England collects interest upon millions and millions of her own indebtedness to other nations. It is a very profitable business to collect interest on what one owes, and it is this which makes England the creditor nation. The United States, as its capital is now organized, can loan to foreign nations only actual capital, and as long as these conditions last cannot compete with a nation which can loan all it dares to owe. *It is not more capital, more wealth, or more money which the United States needs in order to become the creditor nation, but a better organization. The fact that approximately a third of the money of the United States is locked up idle and useless in the Treasury is evidence that we have money enough.*

The capital engaged in banking in the United States is much larger than the capital engaged in banking in Great Britain. I investigated this point a few years ago, and found that the paid-up aggregate capital of all the joint-stock banks of England, Scotland, and Wales, including the Bank of England, was only $345,000,000, while the capital of the national banks alone of the United States at the same date was $648,000,000. The medium of exchange produced by the banks of Great Britain was $3,822,000,000, while the medium of exchange produced by the national banks of the United States was only $2,600,000,000. By their superior organization the banks of Great Britain, with approximately half the capital, produced nearly twice the amount of the medium of exchange.

It was a dream of Sir Walter Raleigh, as it is of some of our

statesmen, that whoever controls the seas will control the commerce of the world, and whoever controls the commerce of the world will control the wealth of the world, and therefore the world itself. But I venture to suggest that you may subsidize ships to sail the seas, and your armies and navies may carry the flag to all the islands of the seas, but you will never control the commerce of the world, nor the wealth of the world, nor the world itself, until you have a banking system which *can manage the exchanges of the world during commercial crises, and maintain at all times a fairly uniform rate of interest.*

I should like to ask those statesmen who seem to think that carrying the flag at the tail end of ships changes the course of trade, at what price a banker in Manila will buy time drafts on New York against consignments, as long as he knows that by the time the draft reaches New York for rediscount the current rate of interest may be any rate between 2 per cent. per annum and a quarter of 1 per cent. per day, or that the banks of New York may then refuse to rediscount at any rate because they are scared; and on what terms could the Manila banker reimburse himself by selling to importers drafts on scared banks! I should like to ask them what they propose to do in the next panic. Perhaps they expect that the President of the United States will issue a proclamation to all the merchants of the world, stating that there is a panic, that half of the banks are "busted," and the remainder are so paralyzed that they will be unable to do business for probably three years, but that he hopes foreign merchants will consign their goods to the United States, but make their drafts on Canada!

The wares of commerce follow the drafts of commerce, instead of a flag, *and the principal reason why Great Britain is the market-place of the world's commerce is not because the Union Jack flies at the tail end of so many ships, but because every banker and merchant in every quarter of the world knows, within 2 or 3 per cent. per annum, the exact value of a draft for rediscount in London.*

Gentlemen, I fear that the length of my address has already wearied you, but I have stated only a few of the historical facts which are available in support of the proposition that the periodical panics which occur in this country are preventable. I hope you will not misunderstand my proposition. I do not claim that a system of

banking has been devised which will prevent periods of undue speculation, followed by commercial crises in which the speculators will be ruined. I do not claim that any system of banking is a panacea for all the difficulties of commerce. But I do claim that there is a tried and proven system of banking which has the capacity so to support legitimate credits during commercial crises as to maintain normal valuations of property, and thereby preserve the legitimate traders, and keep the wheels of industry in motion, and labor fully employed at normal wages. I also claim that such a system of banks is necessary to enable this country successfully to compete in the commerce of the world. I stand upon these propositions.

Such a system of banking in no respect resembles a trust. It does not restrict competition. In a visit to a town of only 4,000 population in British Columbia, I found branches of five of the great Canadian banks competing for the business of that little town. Besides, loss of a life's savings by the insolvency of banks, bankruptcy of solvent debtors, distress of families reduced from comparative affluence to want, lack of labor, a bed on the bare ground in summer and on the bare floor of a police station in the winter, soup kitchens, and other incidents of the panic, are no part of the liberties of the people.

I appeal to you, as representatives of the banking interests, and as patriotic citizens, to give this important matter more than a passing thought. This subject is incomparably of more importance than any detail of internal bank management. Have the courage at least to discuss it, and, if thought wise, put the machinery in motion for another campaign of education. The subject only needs to be properly presented to receive the support of the people.

DESIRABLE CHANGES IN THE BANKING LAW

ADDRESS DELIVERED BY A. BARTON HEPBURN, PRESIDENT OF THE CHASE NATIONAL BANK OF NEW YORK CITY, MARCH, 1902.

It was Jefferson who said, "That country is governed best which is governed least." This, being interpreted, means that men should be protected in their lives, liberty, and property rights with as little

paternalism on the part of the government as possible. In all civilized nations there are certain public utilities or functions intimately affecting the people as a whole, too great and too important to be entrusted to individual enterprise. A government must protect its citizens at home and abroad; hence our armies and navies. Government must provide courts to interpret laws, determine and enforce the rights of citizens and punish those who offend against the body politic. It is equally a duty of government to provide highways for the convenience of travel and interchange of commodities; also for the transmission of intelligence by mail or wire. Experience proves that this latter function may be best exercised by enlisting private enterprise through corporations invested with the right of eminent domain, but subject to government regulation. As a consequence, railways owned by individuals transport persons, property, and the mails, while telegraph and telephone companies, with their quicker service, keep abreast of the age.

There seems to be a growing demand that all these public utilities shall be owned and operated by the government. The trend of events seems to be strongly in that direction. Conceive the entire steel and iron industries of the country under the control of a single corporation. It is but a short step from a single corporate control, where the management has only an investment interest—the hope of dividends—in the thousands of human digits employed, to governmental control, where the management would have a humanitarian as well as a financial interest in the lives and welfare of the employed. Conceive the railways of the country in a single system, or two or three systems, and how long would it be before the inevitable friction between the public and the management would enforce governmental control and ownership? The power of taxation involved in the fixing of prices for great staple commodities, and the fixing of rates of transportation, in its effect upon and its relation to the public, dwarfs in importance the power of taxation exercised by the government for the ordinary purposes of administration. Legislation is invading every field. Questions formerly determined by common law depend upon the construction of a statute. To magnify and extend the functions of government is surely the tendency of the age. This tendency is being accelerated, not by populists or socialists, but by the opposite extreme, the moneyed class—the class

most opposed to such a consummation. The relations between the management of our great industries and the government are necessarily close. Economic laws, export bounties, and tariff restrictions are enacted with a view to fostering industry. Territorial expansion and commercial development seem to have taken the place of territorial expansion and military aggrandizement as the motto and the motive of the nations. The navy of France, hovering along the Dardanelles, recently enforced payment from Turkey of a debt due to citizens of France. The relation between government and individual enterprise is becoming closer and more intimate the world over. The continual extension of the sphere of governmental control and the consequent narrowing of the sphere of individual influence cannot be regarded, I think, except with some feelings of apprehension. It is this tendency that makes it so difficult to take our government out of the banking business. As the government civil list increases, let us hope that civil service principles will become so firmly imbedded in the public mind as to preserve and not endanger the merit system, else the government payroll may become the means of fortifying the party in power.

The banking interests, like all other important interests of the country, are suffering from too much, as well as too little, legislation. National banks are not allowed to establish branches, while the law as to reserve tends to weld the system together and prevent a bank from going into the state system, where branches may be allowed. The large banks in metropolitan centres, with large capital, easily increased as occasion may require, large deposits, large resources, following a natural economic law, would establish branches and agencies throughout this country and other countries, according to the magnitude of their business, and according to the business advantage and probable profit which each locality might offer. In this way the capital of our money centres would be profitably employed, with corresponding advantage to the various interior localities during the periods of their greatest business activity, when commercial needs exceed the resources of local institutions. Such a system would strongly tend to equalize the rates of interest throughout the country, and by so doing minimize the sectional feeling which now exists and is largely predicated upon money conditions. Such a system would insure comparatively few large banks

with branches throughout the country. This would insure the best kind of competition between strong and resourceful institutions. The central institution controlling the resources of the system could bestow its credits where the demand was greatest, thus realizing the best returns upon its funds and affording the public the best service by dispensing its credits where most needed. Such institutions would be splendidly equipped for furnishing a bank-note currency.

There are three central reserve cities, New York, Chicago, and St. Louis, required by law to keep a cash-in-bank reserve equal to twenty-five per cent. of their deposits. There are twenty-nine other reserve cities, each with a population exceeding fifty thousand, required to keep a twenty-five per cent. reserve against deposits, one-half cash in bank and one-half with approved reserve agents in central reserve cities. All other banks are required to keep a six per cent. cash-in-bank reserve, and nine per cent. may be with approved agents in some reserve city. In the smaller towns and cities the greater percentage of actual currency is used. They cannot transact their current business with a cash reserve of less than six per cent. of their deposits. The present law is no restriction at all. If the purpose of the law is to strengthen banks it would be better to require reserve cities to keep fifteen per cent. and the smaller towns ten per cent. cash in bank reserve, and to leave the balance to be maintained with correspondents regulated by the necessity of protecting their drafts and other considerations. Only a national bank can be a reserve agent of another national bank. This provision of the law keeps the larger banks of our cities in the national system, as it is deemed more advantageous to be the correspondent of interior banks than to establish branches, as might be done under some state laws. Then, too, banks not only deal in credit, but subsist upon credit, and a bank would experience difficulty in commanding entire public confidence while doing what institutions organized under the National law are forbidden to do.

As I have stated before, banking, like all other branches of business, following a natural law, would seek to extend the field of its labors and increase its returns by the establishment of branches and agencies. This is shown by the experience of other nations and by the experience of our own states prior to 1860. In nothing is it more strongly shown than by the efforts at present making to

accomplish indirectly the benefits attendant upon branch banking by purchasing control of or an interest in other banks, as many of our leading institutions are doing at the present time upon quite an extended scale. We also read of holding companies and trust companies organized under the laws of the different states for the avowed purpose of acquiring and holding stocks in different institutions throughout the country. The counterfeit is the strongest endorsement that can be given to the genuine.

Congress made pooling agreements by railroads illegal, and under the anti-trust law the Supreme Court held that the fixing and maintaining of traffic rates was illegal. On account of these prohibitions and because of the necessity of having certain and predetermined traffic arrangements with each other, there developed the community of interest and joint ownership system which now obtains. Cost of transportation is a vital element in the cost of all finished products, and in order that a merchant may deal fairly with the public and conduct his business intelligently, he must know the cost of transportation of the commodities in which he deals for a period extending many months into the future. Where his shipments are over not one road, but several different roads, it necessarily follows, in common fairness to the public as well as to the merchant, that these several roads should be allowed to unite in making a rate not only for the present, but for the future. Thus the business interests, confronted by these prohibitions, sought some other method of accomplishing the desired result; hence most of the railways east of Chicago and north of the Ohio have passed into the control of either the New York Central or the Pennsylvania system; and hence also the process of absorption in other parts of the country by means of joint ownership or holding companies or otherwise, which is arousing such keen public interest at the present time.

The prohibition against the establishment of branches and the desirability of close affiliation is developing rapidly a system of joint ownership in banks. To what extent it may be carried, and how successful it may be as a business venture to the investors, and whether it will increase or diminish the ability of such institutions to serve the public, remains to be seen. Such institutions, owned by strong people and in the hands of conservative managers, could certainly render the public great service. If, however, the stock of

one institution be purchased with money borrowed in others of the affiliated banks, it might become in troublesome times a source of danger. In no case can separately organized banks, maintaining separate and distinct corps of officers and organization, be as economically managed as a single bank with branches, nor can they be managed with the same facility, using their funds where most desired, and transferring the same from locality to locality in accordance with the public need.

It is an unquestioned function of government to provide its citizens with currency—money. Money is the ingredient that assimilates all business transactions, reduces all barter to a common unit —a common denominator, and permits set-off and payment of balances. In respect to circulating medium, as with transportation, experience shows that this function of government can best be exercised conjointly with private enterprise—the banks. The best results in government seem to be obtained where paternalism is reduced to a minimum. The proper money function of the government is set forth in the Constitution. It is given the power to coin money and regulate the value thereof—a power withheld from the states—and there, I believe, its function of creating money should end.

Before analyzing our currency, let us see to what extent actual money enters into the actual transactions of the country. Data obtained from the national banks at widely separated periods by several comptrollers of the currency, showing in detail the actual business of the banks as it was transacted for the day, demonstrate that ninety-two per cent. of all the business that passes through banks is consummated by means of credit, witnessed by book-keeping. Economy and convenience have induced a minimum use of money and a maximum use of credit. The amount of domestic exchange—checks and drafts—drawn upon each other by the national banks during the year was $12,999,959,950, and with other banks and bankers included the aggregate would approximate $20,000,000,000. The total exchanges for the fifty-seven clearing-house cities in 1892 were $61,017,832,067, while the balances, which alone were paid in cash, were $4,881,777,289—about eight per cent. The average daily exchanges in the New York Clearing-house for the year 1901 were $262,113,592.10, and the average

balances paid in cash were $12,083,874.97, equaling .046 per cent. Only fifteen minutes are allowed at the clearing-house to complete the exchanges, and about twelve minutes usually consumed. In this modicum of time and with this minimum of money is this vast volume of business consummated.

I give these practical illustrations, not to convey information, but to emphasize the limited office which actual money performs in the barter and trade of our country, and to show how easily a money stringency may be created when credit is withheld, when distrust limits the use of auxiliary currency—checks and drafts—and thus to emphasize the necessity of a currency possessing elasticity. We have in circulation $2,250,256,230 of currency that serves the eight per cent. of business. This currency is created and regulated by the government. We have now in use gold and silver, gold and silver certificates representing actual coin on deposit in the treasury, and subsidiary silver coin. We have greenbacks and certificates representing greenbacks on deposit. We have silver warehouse receipts, issued under the act of July 14, 1890, in use as money, and also national bank notes—nine different kinds of money, differing in their commercial use and money power. Gold certificates represent actual gold on deposit in the treasury and are similar to Bank of England notes, which, with the exception of £17,200,000, represent actual gold on deposit. Silver certificates are the paper proxy for so much coin in the vaults of the treasury, which, notwithstanding it was the "dollar of our daddies," could not be coaxed into circulation in any other way. They are redeemable in silver dollars and "are receivable for customs, taxes, and all public dues, and when so received may be reissued."

The greenback, so called, is a non-interest bearing bond or note representing a forced loan. It is a "legal tender at its face value for all debts, public and private, except duties on imports and interest on the public debt." It is fair to assume that these notes will at some time be retired. National bank notes have a quasi legal function. They are receivable for all debts due the United States, except duties upon imports, and are receivable "for all salaries and other debts and demands owing by the United States to individuals, corporations, and associations within the United States, except interest on the public debt." They are also receivable as between national

banks in payment of indebtedness. The notes issued under the act of 1890 (Sherman law) were given in payment for a commodity which the government did not want, and for no other reason than to placate the silver interests and furnish a note to circulate as money. They are better than the Bland dollar (act of February 28, 1878), because at the time of issue they represented a gold dollar's worth of silver. The Bland dollar never did. The notes issued under this act of 1890 are "a legal tender at their face value in payment of all debts, public and private, except when otherwise expressly stipulated in the contract." Both the Bland law and the Sherman law injected into circulation a fixed amount monthly, without regard to the wants of commerce. However great the demands of trade, the government could not increase the amount, and neither could it diminish the amount, however redundant the volume of currency may have been.

Upon the earnest recommendation of Secretary Chase, reinforced by President Lincoln in his message of 1862, the National bank act was passed early in 1863. It was urged as a measure of currency reform, it is true; but the principal argument, and the one which secured its passage, was the need of the government for a market for its bonds in order to raise necessary funds for the prosecution of the war, which bonds the banks must purchase as a basis for circulation. But little was accomplished, however, until the imposition of the ten per cent. tax upon state bank circulation on March 3, 1865. This gave the national banks a monopoly of bank circulation. The framers of this act had no thought to formulate a currency system for a great commercial nation. Thirty-seven years after the war, with bonds scarce and yielding a very low rate of interest, with little or no profits upon circulation, with population more than doubled and wealth, resources, and volume of business increased in much greater ratio, we are confronted with this provision of law as to circulation unchanged.

I have recounted facts with which you are all familiar to emphasize the unscientific character of our currency. Our currency legislation represents a battlefield in which neither contending force was able wholly to maintain its lines, and compromise has been permitted to work the usual havoc. It is not the result of deliberations of Congress seeking to formulate a currency system for a great com-

mercial nation, but rather of legislation having for its main purpose the accomplishment of some other object. As the period of McKinley's first term was drawing to a close and his re-election was desirable, his political friends realized that prosperity and good times were the strongest guarantees of success. Easy money is a most powerful factor in producing good times. Refunding the presently maturing government bonds into a long-time, low-rate bond, with reduced taxation upon circulation secured by such bonds as an inducement to banks to take them, would insure cheap and plentiful money; hence the gold standard act of March 14, 1900. When good politics and good policy join hands, Congress becomes an attentive listener. It is most unfortunate and almost inexplicable that in a time like the present, so well adapted to calm deliberation and wise conclusions, free from prejudice or passion, this great question of currency reform is absolutely ignored and is likely to remain so until the turmoil of party strife shall again bring it to the front.

Secretary Gage recommends branch banking as the most potent remedy for many of the evils of banking, but alleges that public sentiment will not tolerate it, and therefore seeks approximately to accomplish its advantages by indirection. He also seeks to do away with the arbitrary and harmful disturbance of business affairs occasioned by our subtreasury system. The taxes derived from customs and internal revenue are paid into the subtreasury, the amount being thus withdrawn from circulation. These funds can be again brought into circulation only by payment of some indebtedness or obligation of the government. Whenever the taxes collected exceed the disbursements, currency is absorbed, and the volume available for commercial transactions is thereby reduced. The excess of income over expenditures for the present year is estimated at one hundred million dollars. To obviate the disastrous effect upon trade caused by the locking up of such a very large sum, the treasury is at present carrying $111,000,000 in depositary banks.

The scheme of Secretary Gage, as elucidated by subsequent utterances, is substantially as follows: He suggested a federated bank, and used the Federal government in its relations to the state and local governments to illustrate his banking idea. He would take, for instance, the four thousand-odd national banks of the country, with

their capital exceeding one billion dollars, and let each bank subscribe to the stock of the central or federated bank in proportion to its capital, say 5 per cent. That would create a central bank with a capital of fifty million dollars. Let this bank be controlled by a board of directors elected by the stockholding banks, each $1,000 being entitled to one vote—the central bank to keep accounts and do business with the stockholding banks only; that is, to be a bank of banks. It might perhaps be allowed to loan its funds on demand upon collateral in order to increase its profits when there was no demand for funds on the part of any of its constituent banks; but it should not receive the accounts of corporations or individuals. It should be essentially a bank of banks—a depositary of the public moneys of the government, thus doing away with the subtreasury system and keeping the funds of the government in commercial channels, instead of locking the same up as now; this central bank to have supervision over its constituent members or stockholders, with the power to make examinations as now exercised by the office of the Comptroller of the Currency—to have the right to issue banknote circulation against its general assets or its credit, and in times of necessity to be allowed to issue, with a capital of fifty million dollars, two hundred million dollars of circulating notes—the government not to be represented in the directory or official management of the institution—such a bank to have branches at important points, as, for instance, where the subtreasuries or mints exist at the present time. Such a bank would undoubtedly do away with the principal difficulties and dangers attendant upon the present subtreasury system. It would also furnish a currency good beyond peradventure and elastic—responsive to the needs of business; but if authorized, would it succeed?

The individual localities throughout the country have no surplus money to invest in the stock of a central banking institution, and if the individual banks throughout the country are to be pro rata stockholders in a central bank, they would be at least pro rata claimants for the favors of such bank, and probably would claim its consideration in a much greater proportion than their stockholdings or deposits would warrant. The principle underlying this scheme is the converse of the principle underlying branch banking. Instead of the money centres furnishing capital to the country at large, the

country at large is to furnish the capital of a central bank. The resources of the proposed institution would consist of its capital, government deposits and more or less deposits from its banking stockholders, and circulating notes. Would such an institution allow interest upon daily balances, and, if not, to what extent would the banks of the country maintain balances with it? To what extent would its business harmonize with, or be in rivalry with, the business of its constituent owners? Even without other resources than its capital, government deposits, and its power to issue circulating notes, it would be a very powerful factor in the commercial affairs of the country. By extending credit to its constituent members it would reach all parts of the country, and if it did not allow interest upon daily balances it could afford to adopt a conservative course as to investments, contenting itself with a lesser rate and enjoying greater security.

The joint ownership of this central bank might insure harmony of relations between itself and its stockholders; on the other hand, importunate claimants for undue consideration on account of fancied political or sectional claims, because of the government deposits which the institution would control, might lead to dissatisfaction and possibly bad investments. Such an institution, in possession of government deposits, would be measurably the custodian of the public credit, and must at all times be ready, not only to honor the government's demand for funds, but make a public showing of its assets which would inspire confidence in its liquid condition, both at home and abroad. Would it not necessarily be constrained to loan its funds largely upon the quickly convertible securities of our business centres? In its practical workings, would it not be a disappointment to the rural interests of our country?

Banking is based upon reciprocity. Every individual or corporation maintaining a bank account has a banking equity proportioned to the value of that account, which must be recognized in the form of loans or discounts or other accommodation when required. Otherwise the account would seek a home elsewhere. The exchanges of the country could be liquidated and reduced to cash much more quickly and economically by the clearing-houses of our different cities than by the individual banks. It would be a saving in clerical labor, postage, and otherwise, if the clearing-house of

New York were to send to the clearing-house of Chicago all the items for the day, payable at Chicago and the immediate territory for which it collects, instead of having those items sent, as now, by the one hundred and forty banks now directly or indirectly clearing through the New York Clearing-house. Each individual bank, however, does and will continue to send items to its representative or representatives in Chicago, because the handling of those items is an advantage to its Chicago correspondent and brings reciprocal business in exchange therefor. This principle of reciprocity, or selfish interest, which prompts each institution to direct its business in channels which will bring business in return, would in a measure militate against the success of the proposed federated bank.

Mr. Gage's suggestions literally carried out would amount to a practical consolidation of the banks. I think the interest of the country in banking, as in all other business, will be best conserved by a wholesome rivalry and competition. Mr. Gage's suggestions should be judged leniently, however. He recognizes a public prejudice against branch banking, which is the natural outgrowth of forty years' experience with such a system under the ban of our national laws. He asserts this prejudice or conviction on the part of the public to be insurmountable, and seeks by indirection to approximate the advantages of such a system. That may justify his attitude in dealing with Congress, but in an academic discussion we should insist upon what we believe to be right.

No locality is more in need of an elastic currency system than the city of New York. Heretofore, in times of money stringency, resort has been had to clearing-house certificates to afford relief. Clearing-house certificates are an obligation, issued by a clearing-house to members of that association, secured by a deposit of their assets, with a 25 per cent. margin. These certificates are receivable in the settlement of balances at the clearing-house. They amount to a suspension of specie or currency payment, as between banks, and so far as the checks of individuals or corporations which pass through the clearing-house are concerned, they amount to a suspension of currency payment as between individuals. In 1893 such certificates were issued to the banks of this city by the clearing-house, amounting in the aggregate to $41,490,000. They afforded very great relief to the commercial interests of the whole country.

The conditions at that time were unique. Business conditions were good generally, and the panic was brought about wholly by a distrust of the credit of the government, and the fear that the country was going upon a silver basis. The time has gone by when clearing-house certificates may be safely used in the city of New York. They would materially impair our national prestige as a money power in the world of finance and depreciate our securities as a nation. They would materially injure the banking and commercial interests of our city. Any temporary relief they might afford would be presently more than offset by the diversion of remittances from interior and Western towns, who would send their deposits to Chicago and other cities where currency payments were maintained. The commercial welfare of New York demands that the public be taught—not only our own country, but the world at large—that their money is nowhere safer than in this city, and that it will be returned when called for in any form of payment which may be required.

Panic means business paralysis. The fear of loss induces people to lock up their money and withhold credit, and stagnation naturally ensues. The only way possible for relieving such a condition of affairs is to move the product of the country, be it wheat, cotton, iron, steel, in fact all merchandise, to the markets of the world, in order to realize its value, thereby relieving the stringency and restoring a normal condition of affairs. In the hands of the producers these commodities must be paid for in money. The field-hand, the factory-hand, and labor generally require to be paid in money. Actual currency must perform this function. As a debtor nation in the past it was very well to tide over temporary embarrassment with clearing-house certificates. As a creditor nation, doing business on our own capital and furnishing capital to others, we must have a currency adequate to all needs.

Shortly after the panic or currency famine of 1893, by means of extensive correspondence with every considerable place in the country, I obtained statistics which justify the estimate that there was issued, of clearing-house certificates used in settlement between banks, of certified checks, certificates of deposit, and cashiers' checks, in round amounts (as one, five, ten, twenty and fifty dollars), due bills from manufacturers and other employers of labor, and clearing-house certificates, in round amounts (in the case of Birming-

ham, Ala., as small in amount as twenty-five cents), all designed to take the place of currency in the hands of the public, an amount in the aggregate of one hundred million dollars. Clearing-house certificates, issued and used in settling debit balances to a clearing-house, were in no wise prohibited, but all of the above-described evidences of debt which were issued to circulate among the public as money were clearly subject to the 10 per cent. prohibitive tax, which was enacted for the purpose of getting rid of state bank circulation. This temporary currency, however, performed so valuable a service in such a crucial period in moving the crops and keeping business machinery in motion, that the government, after due deliberation, wisely forbore to prosecute. In other words, the want of elasticity in our currency system was thus partially supplied. The government was powerless to afford relief. Our currency was as unresponsive to the wants of trade as the pyramid of Cheops. Some banks borrowed United States bonds from savings banks and other institutions and took out circulation, but no bank could buy bonds and take out circulation without aggravating instead of relieving the money stringency.

What we need is legislation (or relief from legislation) that will permit banks to do within the law and under wholesome regulations precisely what the banks under stress of necessity did in 1893 in contravention of law. A bank-note is not money. It is a substitute for money—a non-interest bearing obligation of the banks to pay to the bearer a certain amount in legal tender money upon demand. It should not be a legal tender; the legal tender quality would tend to prevent its return for redemption, and thus impair its elasticity. Called into existence by some commercial need, local to the bank of issue, it should appear and disappear at the beck and nod of commerce.

The Imperial Bank of Germany is authorized to issue uncovered notes to the amount of 450,000,000 marks. All notes issued in excess of this limit must have an equal amount of cash held against the same in the reserve. The bank may, however, exceed the limitation of the cash reserve by paying into the imperial treasury a tax of 5 per cent. on the surplus issue, provided, however, that the bank shall maintain at all times a reserve, exclusive of the notes of other banks, equal to one-third of its notes in circulation. During the

acute financial stringency which existed in Germany last year, and from which it has not yet wholly recovered, the Imperial Bank issued over 100,000,000 marks in excess of the limitation of the cash reserve, upon which it paid a 5 per cent. tax into the imperial treasury. Such circulation, so taxed, could hardly be profitable to the bank, and yet it afforded very great relief to the business interests of the empire. Imagine what financial disasters might have ensued had their currency laws been similar to our own. Imagine the advantages to our own country of such a superior currency system, compared with our rigid laws, modified only by clearing-house certificates, limited in their use to bank settlements.

Mr. Gage, in his last report to Congress, recommended: "That any national banking association which shall deposit 30 per cent. of its capital in the form of United States bonds at their par value, and 20 per cent. of its capital in United States legal tender notes with the Treasury of the United States as security therefor, shall be entitled to issue its circulating notes to an amount equal to its paid-in and unimpaired capital. In addition to the deposit of security so required, banks permitted to issue notes as above shall pay semi-annually to the treasurer of the United States, in trust, an amount equal to one-eighth of one per cent. on their capital stocks, respectively, such payments to constitute a guarantee fund for the protection of the note of any bank which, by reason of insolvency, shall become unable to pay its notes on demand." This proposition contemplates a partial retirement of the greenbacks, and authorizes credit currency equal to 50 per cent. of a bank's capital.

Recently, the chairman of the committee on banking and currency of Congress has introduced into that body a comprehensive scheme for currency reform. It does away with the office of Comptroller of the Currency, as now constituted, and substitutes in place thereof a board consisting of three members. Banks are to assume the current retirement of $130,000,000 of the outstanding United States notes, commonly called greenbacks; the government coincident therewith is to retire $65,000,000, leaving only $151,000,000 outstanding. In graduated amounts, covering a period of five years, the banks which assume the current redemption of United States notes may take out asset circulation equal to 60 per cent. of their paid-up, unimpaired capital, and thereafter a provision is made for

an emergency circulation, subject to an increased rate of taxation. The country is divided up into clearing-house districts with reference to note redemption. A guarantee fund is provided by taxation to redeem the notes of insolvent banks. The Secretary of the Treasury is authorized to deposit treasury funds in excess of $50,000,000 (not including the $150,000,000 gold reserve) with the national banks, which are required to pay interest at the rate of one per cent. per annum. Silver dollars are made interchangeable with gold. Branch banking is authorized. The effect of such a comprehensive measure is to unite, in opposition to the enactment of the proposed law, all elements who are opposed to any one of its provisions. It concentrates and unites the opposition, and renders the success of such a proposition more than doubtful.

The greenback was one of the instrumentalities for putting down the rebellion. Its use, its legality, its continuance, were questioned by many and violently assailed by those people least in sympathy with the prosecution of the war, and by the people of the reconstructed states since the termination of the war. Thus the patriotic sentiment of the country was arrayed in support of the greenback. It has received something of the veneration accorded to the old soldier. It is regarded as cheap money by the populace generally, and good beyond question, because it is a direct obligation of the government. Its hold upon public sentiment is so great as to determine in advance the fate of any bill looking to its retirement. And yet it seems impossible for any public official or representative to propose any scheme of currency reform without handicapping his proposition with provisions looking to the retirement of the greenbacks. It seems to me that the wise course to pursue and the practical method of accomplishing results would be to formulate a bill authorizing asset currency simply. Predicate such action upon the necessity and desirability of having a currency responsive to the needs of commerce, that can increase in volume as the population and volume of the business of the country as a whole increases. Let such a currency be once established and in practical operation vindicate its safety and utility; then public sentiment will readily accommodate itself to the idea of the retirement of the greenbacks.

BRANCH BANKING

ADDRESS DELIVERED BY JAMES B. FORGAN, PRESIDENT OF THE FIRST NATIONAL BANK OF CHICAGO, BEFORE THE BANKERS' CLUB OF MILWAUKEE IN MAY, 1902.

OUR subject, in its relation to the commercial, financial, and industrial interests of the country, is one of vast importance, and to us as bankers it is of special significance.

In the evolution of the business methods of the country, so aggressive in other lines, what is to be our permanent system of banking? That such a question should remain unanswered in the present stage of our industrial development seems incredible. That it does so remain, however, is evidenced not only by the persistent agitation of the subject, but by the consensus of authoritative opinion in regard to it. We are not satisfied with what we now have.

The development of a national system of banking in this country has twice been diverted from its natural course. In the first instance by erroneous politics, when President Jackson refused to renew the charter of the Bank of the United States; and again when, for the purpose of creating a market for its bonds, the federal government established our present national system of isolated banks.

Had banking, as in the case of other lines of business, been allowed to work out its own destiny untrammeled by politics and free from subordination to government necessities, a system would ere this have been established which would have made itself felt as a potent factor in the financial affairs of nations. We should also now have a system that would stand together for the public benefit in times of financial distress. As it is to-day, we have no banks that will compare in financial strength and power with those of other countries. While actively competing with other nations in the fields of commerce and industry, it must be admitted that in the world's finance we are away behind in the race; nor does our system even satisfactorily provide for our own domestic requirements. The need of coalition among our unit banks is urgent.

In times of financial distress, instead of standing together in aid of the public, our isolated banks are compelled, by the very law of their existence and by the law of self-preservation, to assume a hostile attitude toward each other. This is why for the past decade

the rehabilitation of the banking business has been persistently advocated. A gratifying feature of recent discussion is that it is being carried on outside the domain of politics. Business men, bankers, writers on finance, university professors, and students are all, from their different points of view, carefully studying the question, and there is reason to hope that it will be settled on its merits. I am not at all pessimistic about it. In other lines of business, through the federation of interests, new methods are being evolved in behalf of economy of administration, and for the better performance of public functions. Some method of evolution will be devised that will federate the interests of the banks so that the individual rights of each shall not be sacrificed.

One thing urgently necessary is concerted instead of independent action in the face of pending danger. Our strength is in our cash reserves, which we should be able to concentrate, instead of being compelled to scatter when danger threatens. Reserves, properly controlled, in times of financial distress will prevent crises. With 10,000 separate banks, each controlling its own small portion of them and scrambling to get that portion into its own custody, our reserves are scattered and the strength of the system is dissipated.

In this regard branch banking has a decided advantage. Under it the cash reserves are controlled by the general management, and are placed where they are needed. They can be moved from one branch to another without reducing the aggregate held by the bank. The money belongs to the bank whether it be locked up in the vaults of the head office or of the branches. The public mind is not therefore alarmed by the fluctuations in cash on hand that take place in the large financial centers owing to shipments to the country. With branch banking a great saving could be effected in the financing of the system.

To illustrate this, suppose a consolidation of the First National Banks of Milwaukee, St. Paul, Minneapolis, Omaha, Kansas City, and Chicago. I have combined the figures of these six banks. Let us then for the nonce imagine them to be six branches of one bank and compare the combined figures with those of the largest Canadian bank—the Bank of Montreal, with its forty-eight branches.

	Of the Combination	Of the Bank of Montreal
The capital	$ 8,750,000	$ 12,000,000
The surplus and undivided profits	6,391,857	8,479,743
The deposits	126,415,117	84,672,239
The circulating notes	2,131,280	8,308,340
	$143,688,254	$113,460,322
The loans and discounts	$ 77,380,975	$ 89,559,026
The government securities	3,786,370	617,697
The bonds and stocks	9,222,901	4,284,352
The banking houses, furniture and fixtures	270,219	600,000
The other real estate and mortgages	262,324	133,306
The due from other banks	27,555,816	9,217,100
The cash on hand	25,209,649	9,048,841
	$143,688,254	$113,460,322

The percentage of cash on hand to gross deposits is 19.6 against 9.7.

The percentage of cash means, including balances in other banks, to gross deposits is 41 against 19.6.

The percentage of balances due from banks to gross deposits is 21.5 against 9.9.

The amount invested in loans and securities as compared with total resources is 62.9 per cent. against 83.1 per cent.

How is it that the Bank of Montreal thus invests 83 per cent. of its total resources, while we can invest only 63 per cent. of ours? The difference in the amounts carried as balances due by banks largely accounts for it. I have shown you that the combination has $27,555,816 in this item against $9,217,100 held by the Bank of Montreal, or 21.5 per cent. of gross deposits against 9.9 per cent. Nor is this comparison strictly correct, for the Bank of Montreal includes balances due by its own agencies in Great Britain and the United States, which probably represent about half the amount. It shows no balance at all due from other banks in Canada. All its balances due by banks are foreign.

Now, how is it that we find this great Canadian bank running forty-eight branches with cash reserves of about 10 per cent. of its deposits and balances due by other banks of say 5 per cent., or available cash resources of only 15 per cent. against 41 per cent. shown by the combination? It is simply because they can do their entire domestic exchange and collection business within themselves,

and have no occasion to deposit any of their funds with other domestic banks. The balances which each of our banks now carries with correspondents for exchange purposes are entirely eliminated when they become branches of banks with officers in the financial centers. If the banks I have referred to were one institution, and, in addition to their six offices in the Northwest, established a branch in New York, the item balances due from other banks would disappear from its statement except as to balances due from banks in foreign countries. This would enable it to loan at current rates from $20,000,000 to $25,000,000 of funds now carried as balances due from banks. In other words, the earning capacity of that amount of its funds would be increased about 2 per cent., yielding some $400,000 or $500,000 a year additional profit. A closer examination of the Bank of Montreal's statement will show this more plainly. A part of its loans and discounts is grouped in its statement along with its cash on hand and balances due from banks. It is thus treated as an immediately convertible asset, and therefore part of its available cash resources. It in fact takes the place of balances due from banks in our statements. It is stated as "call and short loans in Great Britain and United States," and amounts to $29,397,548, or one-third of the bank's total loans. It probably, as I have already indicated, earns for the bank about 2 per cent. more than the corresponding item in our statements earns for us, or about $600,000 per annum, equal to a dividend of 5 per cent. on the bank's capital.

I do not want to be understood as making an argument for a reduction in the legal cash reserves. In Canada, where no limit is prescribed by law, the banks are now being financed on what appears to me to be a dangerously low percentage of cash reserves. In a recent annual report the general manager of one of the strongest banks in Canada says:

> With thirty-one banks, eight held cash exceeding 9 per cent. of liabilities; fourteen carried from 5 to 9 per cent., and ten less than 5 per cent.; some of the latter less than 2 per cent. Five years ago the percentage of cash to bank liabilities in Canada was 9.84. It is now a little over 7 per cent. The decline is significant, and the attenuated cash reserves held in many cases brush aside every argument against fixed cash reserves and call for the immediate enactment of appropriate legislation.

This is a word of warning which should be sufficient to stop

the theorists in this country from arguing for the abolishment of the legal limit of cash reserves. The legal cash reserve is all right; only, were branch banking permitted, it would have to be adjusted to the new conditions. Banks with their head offices in central reserve cities could not maintain 25 per cent. legal cash reserve for the deposits at the branches. It would not be necessary. The discontinuance of the legal reserve of outside banks forming so large a part of the deposits of reserve city banks, which branch banking would bring about, would make a 15 per cent. cash reserve ample. This would be about double that carried by the Canadian banks.

An act to amend the Bank Act is now before the Canadian Parliament, which provides that banks must carry cash reserves of not less than 10 per cent. of their liabilities to the public. A penalty of 6 per cent. per annum on any deficiency for the period of default is expected to insure the observance of the law in ordinary times and provide some elasticity in tight times. This act also appoints a comptroller to take charge of the government inspection of the banks. Canada originally got its branch-bank system from the United States instead of from Scotland, as is sometimes erroneously stated. Alexander Hamilton was the author and founder of it. It was strangled by politics before it took firm root in this country, but was adopted by Canada and allowed to develop naturally. It has been improved upon there from time to time by judicious legislation calculated to build it up and strengthen it. We should not, therefore, hesitate to take back what we gave, if we want it. Our Canadian friends will not grudge us any new ideas which their experience of it may have developed. They got their original ideas from us, and even now propose to adopt probably the only two features of our system which would improve theirs—legal reserve limitation and governmental inspection.

In his annual report, recently issued, the Comptroller of the Currency shows that on September 10, 1901, the national banks had 13.7 per cent. of their total resources on deposit with other banks, while the thirty-four chartered banks of Canada had only 5.1 per cent. so employed. This comparison is striking enough, but does not reveal the whole truth. The national banks do not in their statements separate domestic from foreign balances. The Canadian banks do, and the balances due from banks in Canada amount to the

insignificant sum of only $4,629,921. The aggregate amount of balances due by banks in the combined statement of the national banks is $785,000,000. Probably $85,000,000 of this is due from foreign banks, leaving the enormous sum of $700,000,000 in balances due in account between banks in this country. How much of this amount under branch banking would be available as additional funds loanable to the public it would be difficult to compute. The banks that owe the balances use them the same as they use their other deposits. Were our banks divided up into large institutions, with branches capable of financing their exchange transactions largely within themselves, they would be saved the necessity of carrying balances with other banks. Such balances would exist only between the branches separately and the head office. The branches do not keep accounts with each other, but each has an account with the head office through which its operations with the other branches are cleared. Hence, as already stated, and as shown by the Canadian banks' statements, balances due by one bank to another are practically eliminated. The economy in this must be apparent. The result would be to make a considerable portion of this $700,000,000 available for additional loans to the public, and consequently a further reduction in the discount rate. But this is not the only benefit that would accrue by the elimination of these bank balances. They are really a great weakness, and a perpetual menace to our system.

In the last annual report of Mr. Dawes, as Comptroller of the Currency, he called the attention of Congress to this subject. He pointed out the danger to our system of permitting so large a portion of the legal reserves of one bank to be represented by deposits in another. Mr. Dawes was entirely right in his diagnosis. It is a danger which confronts us whenever public confidence weakens. Whenever individual banks, through fear, withdraw their funds from their reserve agents and fortify themselves by increasing their cash reserves in their own vaults, then enforced liquidation takes place at the financial centers, where weekly reports of the shrinkage are published for the further terrifying of the already alarmed public.

In September, 1892, the aggregate of balances due from banks shown in the combined statements of the national banks was $409,-

523,000. A year later, in 1893, during the panic, it was reduced by $132,000,000 to $277,469,000. During the same period the cash held by the same banks was increased from $347,870,000 to $369,-860,000, an increase of $22,000,000. The bank balances did not recover in amount the figures of 1892 until 1897; since which time they have rapidly increased, and are now, as already stated, the enormous sum of $785,033,000. The fluctuation between 1892 and 1893 is instructive, and the rapid increase since 1897 ominous.

I have prepared a statement showing the greatest possible multiplication of deposits under our present system of allowing a portion of the legal reserves of one bank to be held as deposits in another. For illustration national banks in Deadwood (not a reserve city), Omaha (a reserve city), Chicago (a central reserve city) and New York, the financial center of the country, are used.

		Must be retained in vault as cash reserve		
On a deposit in Deadwood of	$64,000	$ 3,840	$60,160	may be deposited with Omaha correspondent.
Of the deposit in Omaha of	60,160	7,520	52,640	may be deposited with New York correspondent.
Of the deposit in Chicago of	52,640	13,180	39,460	may be deposited with Chicago correspondent.
Of the deposit in New York of	39,460	9,865	29,595	may be loaned.
Totals	$216,260,	$34,405		

Total deposits shown, $216,260, is 337.90 per cent. or original deposit, $64,000.
Total cash in vaults, $34,405, is 53.8 per cent. of original deposit, $64,000.
Total cash in vaults, $34,405, is 15.9 per cent. of total deposits shown, $216,260.

Therefore, although 53.8 per cent. of the original deposit is held in the vaults of the combined banks, the reserve on the combined deposits is only 15.9 per cent.

This illustrates our method of artificially increasing bank deposits and their greatest possible multiplication under our national system. The actual increase is not so great, because local use is found for the greater part of local deposits. The method is, however, extravagant of reserves and encourages expansion on a fictitious basis. It demands attention in the interest of sound, conservative, and eco-

nomical finance. In good times, such as we have been having, we pile up trouble against the day of trouble, when values shrink, credits are curtailed, and distrust prevails. The worst instance of this is found in reciprocal accounts kept for no other purpose than to swell deposits. There is no profit in them, and they can at any time be wiped out by offsetting one balance against the other. In periods of depression they disappear like the morning dew before the rising sun.

I am not surprised that Mr. Dawes should sound a note of alarm. But his remedy was not practical. He proposed to change the present law so that one-fifth instead of three-fifths of the 15 per cent. legal reserve of banks, not reserve agents, may consist of balances due by reserve banks, and that banks in reserve cities be compelled to keep their entire legal reserve in the shape of cash in their vaults the same as those in central reserve cities now do. This would simply require the banks, by legal enactment, to do deliberately what we complain of their doing under panic. Were it once accomplished the system might be permanently put on a strong basis though it would be a very extravagant one. But what about the process of accomplishing it? Could the system stand the withdrawal from the central reserve cities of practically all the deposits which now form part of the legal reserves of the banks in the reserve cities, and the withdrawal of two-thirds of the deposits from the reserve cities which form the legal reserves of their correspondents? The question has only to be put to show the impracticability of it. The real cure is in branch banking, in connection with which, in his arguments against it, Mr. Dawes is now showing as little practical knowledge as he did about our national system when he made such a radical recommendation without realizing the danger of it.

That branch banking would correct this weakness, and at the same time effect a decided economy, can be demonstrated. For this purpose I have taken sixty banks in Illinois and combined them with their Chicago correspondent, the First National Bank.

STATEMENT OF FIGURES IN A SUPPOSED COMBINATION OF SIXTY ILLINOIS NATIONAL BANKS WITH THE FIRST NATIONAL BANK OF CHICAGO, ILLINOIS

LIABILITIES

	First National Bank of Chicago	60 other National Banks in Illinois	Combined
Capital	$ 5,000,000.00	$7,208,000.00	$12,208,000.00
Surplus and undivided profits	3,791,631.06	5,052,627.77	8,844,258.83
Circulation outstanding	942,860.00	3,662,005.00	4,604,865.00
Due by First National Bank of Chicago to the other sixty Illinois banks (actual)	3,907,134.43	....	....
Due to other banks	35,632,663.49	6,409,343.67	42,042,007.16
Deposits	32,523,650.36	38,060,084.42	70,583,734.78
Other liabilities	0	12,000.00	12,000.00
Total	$81,797,939.34	$60,404,060.86	$138,294,865.77

ASSETS

Loans, discounts, and overdrafts	$45,186,515.78	$35,061,623.66	$80,248,139.44
United States bonds	1,345,530.00	5,243,162.63	6,588,692.63
Stock, securities, etc.	5,849,152.45	3,523,244.06	9,372,396.51
Banking house, furniture and fixtures	0	798,115.65	798,115.65
Other real estate and mortgages	0	223,979.89	223,979.89
Due from First National Bank of Chicago to the other sixty Illinois banks (actual, as *per contra*)	....	3,907,134.43	....
Due from other banks (eastern exchange)	11,540,645.49	6,859,922.04	18,400,567.53
Cash and cash items	17,876,095.62	4,786,878.50	22,662,974.12
Total	$81,797,939.34	$60,404,060.86	$138,294,865.77
Eastern Exchange	16.1%	*24.2%	16.3%
Cash and cash items	24.8%	10.7%	20.1%

*Balances due from First National Bank of Chicago included.

The aggregate cash resources of the sixty-one would be the reserves of the one combined without regard to their location. The transfer of cash from one branch to another would not change the total. The aggregate balances carried in Chicago by the sixty, amounting to $3,907,134.43, would be eliminated, and their aggregate balances due from other banks, amounting to $6,859,922.04, would become part of the eastern exchange balances of the combination. This combination would therefore result in a reduction of

$3,907,134.43 in the balances between banks, without reducing the amount of loanable funds, and at the same time $6,859,922.04 of eastern exchange could be converted into loanable funds, for the balances previously carried by the Chicago bank, amounting to $11,540,645.49, would be ample for the purposes of the combined bank. You have only to combine with the First National Bank of Chicago all the banks that keep their Chicago accounts with it, in order to eliminate from its statement the entire $35,632,663.49 which it owes to other banks. And, to go still farther, were it to establish its own branches in New York and a few of the other principal eastern cities, it could be financed without balances due to it by other banks except as to foreign accounts. This is the condition of the Bank of Montreal and the other large Canadian banks with branches, as we have already seen them. The economy to the system as a whole in such a method of financing is self-evident. The borrowing public would be the ultimate beneficiaries by the large increase in the volume of loanable funds and consequent reduction in rates.

The financing of the combined bank being under central control, cash and cash balances with correspondents could be switched around as circumstances required, without changing the total. As separate institutions, however, not one of these sixty-one banks can of its own action increase its cash on hand except by draft on a correspondent for the amount, which to that extent reduces the correspondent's deposits and cash on hand. Under ordinary circumstances this works no harm. The demands on reserve city banks for currency shipments are promptly and cheerfully responded to when times are good and money is plentiful. But when shrinkage in values and general liquidation set in, when confidence is weak and cash balances run low, the effect of our present method is to intensify the strain by scattering the cash reserves of the system far and wide in small, isolated, and entirely independent piles. Thus is the country's financial strength dissipated and panic produced.

Just the reverse of this would be the result of concerted action under central control. Money would be placed where it was most needed, while the cash on hand of each central bank and all its branches would be made public without reference to its different locations. A proper average reserve could be maintained, as it

would make no difference at which of the branches the cash was on hand so long as the whole of it was counted in the reserves of one combined bank. The withdrawal of money for the strengthening of 10,000 individual banks would no longer reduce the reserves of the banks in the reserve cities below the legal limit, compelling them to resort to clearing-house certificates.

As I have already stated, the aggregate cash held by all the banks in the national system was $22,000,000 greater in 1893 than it was in 1892, notwithstanding the enormous shrinkage in deposits and the scarcity of it at the financial centers. If all, or nearly all, the banks outside the reserve cities had been branches of the banks in the reserve cities, so that their increased cash on hand could have been counted as the reserves of the branch systems, it would have been seen that there was plenty of money in the country and no occasion for panic. But practically the only cash balances that received public attention were those of the New York banks. The money was in the banks of the country in increased amounts, but it was not discernible; there being no means of directing public attention to it, nor any method of showing the combined reserves of all the banks as the strength of a system. This is virtually an admission that in reality we have no system, but 10,000 unit banks under independent management, each acting for itself without regard to the effect of its action on the others.

Under the branch-banking system the cash reserves are kept principally in the financial centers, or redemption cities. They are seldom or never needed outside of them, the transactions of whole sections being cleared daily at these centers with great economy of both money and work. Under our system, in small communities banks are started with $25,000 capital. In the event of the failure of some local industry, depositors become alarmed. They have no difficulty in gauging the strength of their bank. They know the amount of its small capital and smaller available resources. They conclude that it would not take much to break it, and, proceeding to withdraw their deposits, they accomplish by their own action the very thing they feared would happen. The matter is largely one of confidence. Branches of large banks establish such confidence that alarm is not easily taken and runs are unknown. Small branches can, therefore, be managed with great economy in the matter of cash reserves.

Where there is an issue of assets currency in connection with branch banking, as there frequently is, the branches are virtually circulating agencies of the parent-bank's notes, and the entire circulating medium for the district is satisfactorily provided through them. On the other hand, it is well known that our small banks cannot supply the borrowing requirements of the larger industries in their location. The legal restriction put upon their loaning power makes it impossible for them to do so. This, notwithstanding that many of them have to look outside their own localities for the investment of their surplus funds. In consequence of this, it has become the practice for the larger manufacturing concerns and business houses to place their paper through brokers in the financial centers. With too many of such concerns credit is no longer based on a proper understanding with their bankers, but depends on the ability of their brokers to sell their paper, in such amounts as the various markets in which it is offered will absorb. There is practically no check on the amount issued outside of the limit of the market for it. This is a serious defect, begotten of conditions produced by our system of individual banks. Under a branch-bank system surplus funds are taken from one locality and loaned in another, under the direction of the general management. Through central control, the branches would thus be able to supply the entire borrowing requirements of their different localities at the current rates of discount prevailing in the centers. They would have local use for their own funds, and if more could be legitimately used they would be supplied from headquarters. We should no longer find the paper of some concerns offered in half a dozen different markets by as many different brokers. Bankers would get into closer touch with borrowers and have a better knowledge of what they are doing for them. This would not only be better banking, but would be much better for the borrowers themselves, who could make all their financial arrangements at home, and have such arrangements as could be relied on. Good customers who want only what they are legitimately entitled to, and what any bank in a position to do so would gladly grant them, would certainly prefer this. Good borrowers would thus be properly taken care of and the plungers exterminated.

There are many other advantages connected with branch bank-

ing—such as economy in the expense of management; better opportunities from a professional standpoint of training young men for the business; greater encouragement for young men to engage in the business as a final calling, a managership being within the reach of everyone of ordinary ability and industry.

Such, from my point of view, with a practical experience of both systems, are some of the advantages to be gained by the adoption of branch banking. I am far from holding it up as a cure for all the ills that bankers are heir to. Branch bankers have their troubles just as we have ours. Nor am I blind to the advantages of our national system as advocated by its admirers. There is something in the argument of the interest which each community takes in its own institutions, and the benefit of having a bank under local control to build up local industries. I have read with much interest Mr. Frame's criticism of some of the views expressed at the convention of the American Bankers' Association held here last October.[1] It is an able paper and carries conviction with it in many particulars. But with the conclusions at which he arrives, as tersely stated in the few words he addresses to the bankers of the United States, I cannot agree. He says: "Branch banking means monopoly. Monopoly means revolution in banking. Are you ready to surrender?" I am as much opposed to monopoly and revolution as he can possibly be. Branch banking does not mean monopoly, and I believe it can be brought about by evolution and without revolution. Competition would be keener through the country under branch banking than it is now. Branches are established in every village in Canada, and in many towns there are more branches than one where a $25,000 national bank under our system could barely exist. There is no intention, nor would there be opportunity, of having the whole absorbed by one which would be monopoly. Even with a branch-bank system we must always have a large number of banks competing for the enormous business of this country. Mr. Frame admits this when he says:

> As Great Britain has 129 great banks with over 5,500 branches, his (Mr. Stickney's) parallel for the United States would indicate, say, 250 large central banks with more than 10,000 others as tails to the big kites. In short, his scheme was simply to revolutionize our banking system.

This is surely not monopoly that he thus describes, but active com-

[1] This article was published in the *Banker's Magazine* under the title, "Branch Banking and Asset Currency," December, 1901.

petition among 250 kites with 10,000 tails all flying for business. In regard to revolutionizing the system, my imagination does not follow Mr. Frame's prediction, for where he sees the sudden upheaval and quick action of revolution I can see only the slow and gradual process of evolution—a process extending over at least a generation, and probably a century or more. The permission granted to national banks, under proper restrictions, to establish branches cannot immediately change five thousand of the existing banks into branches of the remaining five hundred. Consolidation and absorption are matters of negotiation and bargain, and therefore slow and gradual as conditions change and opportunity occurs. It always has been so. In England the evolution from individual local banks to branch systems has been in progress for a hundred years and is still in operation. In Canada the system has been one of gradual development, and there still remain local banks actively competing with branches for the business of their localities.

One of the first official acts of any importance assigned to me, twenty-five years ago, was the examination of the Union Bank of Prince Edward Island in contemplation of its consolidation with the Bank of Nova Scotia. The merger was accomplished, and since that time the Bank of Nova Scotia has had its branch in Charlottetown competing with the branches of other large banks and with the Merchants Bank of Prince Edward Island, another local institution which has retained its local organization and individuality with a capital of $300,000, on which it pays 8 per cent. dividend. Later I was called upon to establish a branch of the same bank in Liverpool, N. S., on the ruins of two local institutions which went into enforced liquidation in consequence of local business conditions beyond their control. Still later I undertook the preliminary negotiations for the establishment of branches at St. Stephen and Fredericton, N. B., where, in the former, the St. Stephen's Bank, with a capital of $200,000, had for many years done business and is still in existence, paying 5 per cent. dividends; and in the latter, the People's Bank of Fredericton had for many years done business and is still active with a capital of $180,000, on which it pays 8 per cent. dividends.

In Yarmouth, N. S., a branch has been in existence for three-fourths of a century, competing with two local banks, one with

$300,000, the other with $264,000 capital, on which they each pay 5 per cent. dividends. In Windsor, N. S., the Commercial Bank, a local institution, held the field entirely to itself for more than a quarter of a century with a capital of $350,000, on which it pays 6 per cent. dividends. In St. John, N. B., the Bank of New Brunswick, until within the last few years a purely local institution, has done business on a capital of $500,000, in competition with branches of the largest banks in Canada, and pays 12 per cent. dividends. In other places through Canada local banks are actively competing with branches of the large banks. Comparatively, however, they operate at a disadvantage from the standpoint of economy, and are not therefore so remunerative on capital invested as are the large banks.

These matters I recall from my personal knowledge and experience; and, after all, experience is a better guide than theory. I mention them to show that no such thing is likely to occur as that predicted by Mr. Frame. He anticipates that "the 10,000 banks in the United States will have a monopolistic brood of 250 great central banks politely or otherwise saying to them: 'Either sell out or get out of business.'" The facts are that local institutions will neither have to sell nor to get out of business, unless they deem it to their advantage to do the one or voluntarily do the other. With the deposits of their localities in their hands, and with local interest and influence to support them, they would be in absolute control of the situation. In any negotiations looking to consolidation or the purchase of their business they would hold the commanding position and would be well fortified to protect their rights. They would have the good-will of an established business, the value of which they would no doubt know. They could retain it and continue in business, or they could dispose of it when they got ready at a competitive price; for they would have more than one central bank to dicker with. The officers would practically retain their positions and their standing in the community, as their connection with the business would necessarily have to be maintained. Each individual case would have to be dealt with on its merits, and I see no reason to fear that the rights of any individual or institution would be disregarded or interfered with. Changes in methods and systems naturally beget fears and misgivings, and it would be strange if such an important suggestion as this did not produce them. I see no cause

for apprehension, however, as I see no reason to believe that, were the power granted to banks in this country to open branches, the result would be any different from that which experience has shown it to be in other countries where the system has been adopted. We have no banks to-day so equipped that they could start branches except in the most initiatory manner.

The only possible way the system could be developed would be by the slow process of consolidation with such banks as might be willing to negotiate toward that end. That would mean one deal at a time, and unless both were willing there could be no merger. That it would come about by gradual evolution, if it were permitted, I do not doubt. For, although prejudice and individual interests might retard it, these would be overcome when the public became familiar with the great advantages of the system.

There does not seem to me to be room for question that the branch system would serve the public better than our present system does; that it would be stronger, safer, more economical, furnish a much larger volume of loanable funds from the same amount of resources, provide better facilities for collections and domestic exchange, and therefore reduce the current rates of discount and other charges, and so distribute loanable funds that the rate of discount would be practically the same from one end of the country to the other. It would be another case of the survival of the fittest. It seems to me a perfectly natural evolution from our present system, and one that must come about sooner or later. It has already commenced in Greater New York. The Colonial Bank, closely allied with the Hanover National, has five or six branches; the New York Produce Exchange Bank has four; the Corn Exchange Bank has ten and is shortly to open another. This suggests another advantage of the system to the public—the establishing of branches in convenient localities in the large cities. Branches of the large banks are scattered all over London for the convenience of the public, and in the other large cities of Great Britain and Canada the same system prevails. If we in Chicago had even the power to establish branches in our own city, what a great convenience to the public it would be! We have customers coming for miles in all directions to do their business on Dearborn, Monroe, and La Salle

Streets, where we are all huddled together without any regard to the convenience of our patrons.

My subject, branch banking, does not necessarily involve assets currency. We can have the one without the other. In closing, however, I desire to say, without argument, that much as I should like to see assets currency become a part of the banking system of this country, I have never been able to make up my mind that it could be safely or satisfactorily connected with our present system. To me the simple statement that about 10,000 banks, with capitals running all the way from $25,000 to $25,000,000, would have the privilege of issue, settles it as impractical and impossible. Proper facilities for its redemption are impossible, and proper provisions for its safety are equally impossible. No such scheme has ever been successfully attempted in the world's history, and no such conglomeration of credit obligations was ever floated in the name of a monetary circulation. The first essential for a safe assets currency is large capitalization of the individual banks that issue it, and the second, of equal importance, is ample facilities for its prompt redemption, not only at the counter of the bank that issues it, but in the financial center of every state in the Union. Neither of these could be adequately provided under our present system. I would therefore suggest that we drop the question of assets currency until, by permitting our large banks to establish branches, we develop a system that will be able to support it.

BRANCH BANKING

ADDRESSES DELIVERED BY HORACE WHITE, OF NEW YORK, AND HENRY W. YATES, OF OMAHA, IN DEBATE BEFORE THE JOINT CONVENTION OF THE MISSOURI, KANSAS, OKLAHOMA, AND INDIAN TERRITORY BANKERS' ASSOCIATIONS, IN MAY, 1902.

Remarks by Horace White:—

LET us begin by defining the phrase branch bank. It is oftenest used to signify an office having no independent capital of its own, which belongs to, but is geographically separated from, a bank. The branch is thus separated from the bank in order to attract cus-

tomers who live at a greater or less distance from the head office—for the same reason that a drug store down-town may find it profitable to establish a branch up-town. The credit of the parent bank always attaches to the branch bank, but the capital may or may not be with it. More capital may be collected at the branch in the form of deposits than can be profitably used there. In that event the surplus will be drawn to the parent bank. Most probably, however, there will be times when the head office will be sending money to the branch, and other times when it will be drawing money from it. The sole reason for branch banking is that this flow and counterflow may take place according to the needs of business, with the least loss of time, with the smallest amount of friction, and hence with the greatest profit to the bank.

The phrase branch banking is also applied to a group of banks, each of which has a capital of its own, but all of which are under a common management. If such a group is situated in a single country, under modern conditions of rapid communication, the modus operandi will be the same as in the other case. If they are in separate countries, however, there must be an assignment of a certain amount of capital to each of the branches in order to save time and expense in transferring funds from one to the other.

There is a wide diversity of opinion in this country as to the advisability of branch banking, and this diversity exists largely among bankers themselves. The mass of the people know nothing about it, and few of them care enough about it to study the question. The doctrinaires, the college professors, the economists, are generally in favor of branch banking. They are not, however, so far as I know, in favor of forcing that system upon the national bankers against their will. If I were a banker, and if I believed that branch banking would injure my business, I should be opposed to it, and especially if, while holding such views, I were a trustee of bank capital for other people. Whether branch banking be conducive to the general interest or otherwise, it is not a soul-stirring matter. Patriotism is not concerned in promoting it. Some people think that patriotism is concerned in opposing it, and that branch banks, if permitted to exist, will destroy American liberty. Such persons do right to oppose it. Those who think that it would be, on the whole, a wise policy for the country, agree that they have no

special claim on the public attention, and I, for one, do not believe that branch banking will ever be adopted by Congress until the majority of bankers acquiesce in it. Nevertheless, I believe that it will come, because I believe that it will be economical and profitable to all banks in both city and country, and that it will extend and enlarge instead of crippling their business, and that after trying it they will wonder why they were ever opposed to it.

It is a matter of history that when the country banks of New England were asked to redeem their notes at the Suffolk Bank in Boston, and to pay the Suffolk a small compensation for its trouble, they declared and sincerely believed that such a policy would ruin them. Yet after a trial of the system they found their credit so much improved and their circulation so much extended, that nothing could have induced them to abandon it. So, too, I think that it would have been impossible for anybody to tell beforehand what would be the consequences and effect of branch banking. For my own part, I know of no way to judge the future but by the past. I feel sure, however, that what has happened before will happen again under like conditions, and that what branch banking does in other civilized countries it will do here if the opportunity is offered.

We had five examples of branch banking in our own country before the civil war. These groups of banks had one hundred and one branches. They existed at various times from the foundation of the government to the end of the civil war, during a period of great disorder in banking, amounting at times to financial chaos. There were five general bank suspensions from 1791 to 1861. Not one of these banks or branches failed during that period. Now the test of solvency is the supreme test of banking, and if we find a particular system that passes this test for three-quarters of a century while failures of individual banks are frequent and disastrous, we may reasonably infer that this immunity is due, in part at least, to the system itself. This is not saying that, under the branch system, banks never fail—there have been two or three bad failures of such banks in Scotland; but we may fairly infer that the people have greater confidence in a group of banks linked together and co-operating with each other than they have in the same number of banks separate from and competing with each other. Public confidence is the sine qua non of successful banking, and the system which best

assures such confidence is the one which should receive our favor.

We will now glance at the experience of other countries, and first at that of our neighbors on the north. In Canada there are thirty-four banks with an aggregate capital of $67,591,000 and a surplus of $37,365,000. Thus the average capital is $2,000,000, and the average surplus $1,000,000 to each bank. No new bank can be established with less than $500,000 subscribed, of which at least $250,000 must be paid before beginning business. All of the larger banks have branches, of which there are 690 in the Dominion, situated in 392 localities. Each bank is allowed to issue notes to an amount equal to its paid capital, but competition and the prompt return of the notes for redemption have always kept the circulation below the authorized amount. All banks are required by law to make arrangements to insure the par value of their circulation in any and every part of Canada, and for this purpose to establish redemption agencies at the chief cities of each of the seven provinces and at such other places as may be determined by the treasury board. In practice the notes of the different banks are exchanged daily at the clearing-houses in the larger cities. At other places they are exchanged between the nearest branches, and balances are paid either in Dominion notes or by drafts on the commercial centres. There is, accordingly, no discount on any Canadian bank note in any part of the Dominion. Nor is there any discount on the notes of failed banks. The law provides for the protection of noteholders (1) by giving them a prior lien on all the assets of failed banks, including a double liability of the shareholders; (2) by a bank circulation redemption fund contributed by all the banks, equal to 5 per cent. of the average circulation of each; and (3) by a provision that the notes of failed banks shall draw 5 per cent. interest from the time of default till public announcement is made of readiness to redeem them. There have been three bank failures since 1890, when these provisions of law took effect, but the noteholders lost nothing; nor did the other banks lose anything from the common redemption fund.

The Canadian system of branches tends to equalize the rates of interest in different parts of the Dominion. A bank receiving deposits in Halifax, Montreal, and Toronto may lend them the following day through its branches, and by the issue of its own notes,

at Winnipeg, Vancouver, and Victoria, the branches redeeming the notes by drafts on the head office. The rate of interest in the smaller towns of the West is only 1 or 2 per cent. higher than in the large cities of the East on the same kind of loans. To this equalization of the rate of interest both the branch system and the freedom of note issue contribute. Under the branch system in Canada the parent bank is like a reservoir having pipes of different sizes running to different consumers, each of whom can draw as much from the general supply as he can advantageously use and give security for.

The country in which branch banking has received the highest development, however, is Scotland. There are ten banks in that country with an aggregate capital of $46,000,000 and a surplus of $35,000,000. The capital and surplus, if equally distributed among them, would be $8,000,000 each. They have all together 1,065 branches. One of these banks, the Commercial, whose head office is in Edinburgh, has 139 branches, and thirteen of these are in the city of Glasgow. The Union Bank, whose head office is at Glasgow, has 143 branches, and ten of these are in Edinburgh. This system has grown up during the past two hundred years to its present perfected state. It has met some disasters in that time, but comparatively few. There have been only three bank failures of any importance in Scotland—that of the Ayr Bank in 1792, of the Western Bank in 1857, and of the City of Glasgow Bank in 1878. All of these failures were due to speculations of a most disreputable kind, carried on with the money of the banks by the connivance of the directors. By means of this branch system deposits are secured from every nook and corner of the country, and capital is transferred easily and quickly to the places where the demand for it is greatest. There is no hamlet so small that it cannot obtain banking facilities adapted to its needs. Whatever assistance banks can give to industry, is available to the poor and the rich on equal terms. In no other country, except possibly in France, has the doctrine of equality in bank favors been carried so far. If I were asked to name the countries where the democratic principle has reached its widest application in the matter of loans and discounts, I should name those where the branch-bank system has received its highest development and has been pushed to the greatest extreme. And here Scotland would stand in the front rank. If I were asked to name

the country where agriculture has received and still receives the greatest help from banks, I should name Scotland. The branch bank adjoins the inglenook everywhere, and "cash credits" are available for every farmer of good character. A cash credit is a permission extended by the bank to a borrower to draw money as it is wanted, not exceeding a certain sum, paying interest for the time and amount actually used. As a corollary to the cash credit system the bank allows interest on all deposits, and thus the habit of saving is stimulated among the people.

The circulating notes of the Scotch banks are exchanged daily at the Edinburgh Clearing-house, and settlements are made between banks by drafts on London. No deposited security for bank notes has ever been required in Scotland, but noteholders have a prior lien on the assets, and the liability of shareholders for note issues is unlimited. For these reasons the note issues of insolvent banks in Scotland are always accepted at par by the other banks, and are never depreciated. Although deposits are received and loans are made at each branch, the branches pay out only the notes of the parent bank, which are redeemable at the head office. So it is necessary to have real money only in one place, instead of one hundred different places.

The Bank of France is required by law to have at least one branch in each of the eighty-seven departments into which the country is divided. It has now 392 branches. Some of these are subsidiary offices in places too small to support a branch with the usual complement of officers and employees. In some places the branch or office is only desk-room, is open only once or twice a week, and is served by an agent who serves other branches on other days. The rate of discount is uniform at the parent bank and at all branches and offices. During recent years it has been usually 2½ to 4 per cent., and is less fluctuating than in any other country. No paper is rejected on account of its smallness. Loans of five francs are not uncommon. In 1889 there were at the parent bank nearly 20,000 discounts of ten francs ($1.93) or less each, and more than 1,000,000 ranging in size from 51 to 100 francs.

The Bank of France has a monopoly of note issue, and its notes are what we call "asset currency." Its present circulation is about $800,000,000, and its specie holdings $720,000,000, of which $500,-

000,000 is gold. It is much the largest bank in the world. Its assets and liabilities foot up one billion dollars. Yet it has numerous competitors in its own territory, among them the Crédit Lyonnais, with a capital of $50,000,000. The Crédit Lyonnais has twenty-six branches in Paris and its suburbs, 116 in the departments, and twenty-six in foreign countries.

The Imperial Bank of Germany has 320 branches. It has the right to issue $110,000,000 of circulating notes, regardless of its cash reserve. It may issue as many more as it has cash on hand, and as many above that figure as it chooses, by paying a tax at the rate of 5 per cent. per annum on the excess, until it has outstanding three dollars of notes to one dollar of cash. The latter is what we call "emergency circulation," and the bank has several times availed itself of its permission to issue it, to the great benefit of the business community, and incidentally to the imperial treasury. There is nothing in the branch-bank system of Germany, however, that calls for special attention.

I might go on and recite the experience of other countries, but we should find no novelty among them. In the year 1896 our government called for reports from its diplomatic agents on the banking system of other countries, and asked specifically whether branch banking was allowed in them. Replies were received from forty different countries, and all of them said that branch banking was permitted, and in most of them practiced. Of course, it would not be practiced if it were not profitable. If it is profitable in Canada, in Great Britain, and on the continent of Europe, it would probably be so here. So the question before us is whether the law ought to prohibit a kind of banking which would be advantageous to the persons engaged in it, which is not dishonorable in itself, which is practiced in all other countries, and which was extensively practiced here before the National Bank Act was passed.

It may be said that if branch banking were permitted, the large banks would open branches in the small towns and take away the business of existing banks. They could do so only by offering loans at lower rates to the business community, or by giving them better terms in exchange for their deposits. Competition is always inconvenient, and we need not expect to make it look attractive to any class, whether bankers or other; but competition is not to be avoided

by preventing branch banking under the national system. New state banks are starting up all the time in places where national banks exist. I have a book which tells how Mr. W. S. Witham, of Atlanta, Georgia, has started twenty-six banks as branches of a parent bank in Atlanta, of which he is the president. These are not national banks, but they are competing banks all the same. They get deposits and they make loans. These branches are managed by local directors, just as the branches of the State Bank of Indiana were in the olden time; but Mr. Witham is the president of each branch and he appoints the cashier of each.

This, however, is only a symptom of a mightier movement in the way of bank extension now going on. Scarcely a day passes that we do not read of some existing bank passing under the control of a larger one. During the last six months there has been much quiet absorption of small banks in New York City by large ones, and latterly the process has been extended to banks outside of the city and outside of the state. Not only so, but some of the large banks in cities far distant from each other have been exchanging shares through the persons of men who own controlling interests in each. A bank president from an interior town in Missouri, which contains two banks, was in New York a few days ago in order to arrange for an affiliation with one of the large city banks. He had heard that his competitor, which we will call Bank A, was negotiating for an affiliation of this kind, and he did not intend to be caught napping. He wanted to be able to say at once that his bank (Bank B) had just as strong connections as Bank A. Why did Bank A desire to establish relations of this kind with a large city bank? Because it believed that it would acquire more importance in the eyes of the community and get a larger line of deposits thereby. Other things being equal, the depositor puts his money in the strong bank, because he considers it safer. No bank likes to lose its relative importance in the financial world. Therefore, this movement of weak banks seeking the alliance of strong ones is likely to go on.

Congressman Hill, of Connecticut, in a speech at New York last week, gave an item from his own experience. "A few days ago," he said, "I sold some stock in a Kansas bank at 125, which for the last three years has been unsalable at par. It was bought by

the managers of a Missouri bank, and the organization will hereafter be, to all intents and purposes, a branch of the larger institution. The necessities of the community were greater than the limited capital of the little bank could meet, and the expense of management consumed the profits. Now, all the legitimate wants of that vicinity will be met by the aid of the larger bank, and the increased patronage and reduced expenses will fully justify the price paid for the established business and unused good-will, and all parties will be benefited."

I presume that branch banking in this shape is robbed of much of its terrors to the small bank. The next thing that will happen, probably, in the case mentioned by Congressman Hill, will be that the little bank thus cheerfully converted into a branch will establish an office in some smaller place which now has no banking facilities at all—an agency like those of the Scotch banks, where it would not be profitable to have a fully equipped branch, but where some deposits can be obtained and some profit made. This will be of benefit to the community and to the banks.

Are these affiliations sufficiently cohesive to be classed as branch banking? Undoubtedly they are intended to be so. It would not be worth while for a bank seeking a branch in this way to be satisfied with less than a majority of the shares, but a national bank is not permitted to buy the shares of another bank, although it may lend money on them. We must suppose, therefore, that the amalgamation which is now taking place here and there is accomplished by individuals connected with the large bank, who buy the shares of the small one, and borrow from the former the money which pays for them, shares being pledged as collateral security for the loan. When the borrower dies the loan must be shifted, and this shifting may make the control insecure, but there is no doubt that means will be found to perpetuate a control once obtained. The main question is whether the union of the two turns out to be profitable. If it does, it will be permanent, and the bank whose shares have been bought in this way will continue to be a branch of the other.

That such union will, in general, result in profit to the bankers concerned, there is every reason to anticipate. Congressman Hill, in his speech to which I have just referred, presented figures showing the percentage of the cost of loans in banks of large and of

small capital, respectively; that is, the amount of expense that the banks incur on each dollar they invest in loans and discounts. Of course, the percentage of cost is much less in any large business than in a small one. In railroad transportation, for example, the percentage of expense grows less and less as the volume of traffic grows greater and greater, until the full capacity of the road is reached; and the same rule holds good in banking. But nobody could have imagined so large a difference in expenses as Mr. Hill found to exist between different banks in this country. According to reports compiled by the Comptroller's office, the percentage of expense to loans in ten large New York City banks was 1.68; in ten New England banks of $100,000 capital each it was 3.94; in ten banks of $50,000 each in Iowa and Nebraska it was 5.33; and in ten banks of $25,000 each in various parts of the country it was 7.00 each. The wonder is that these banks of $25,000 capital can exist at all, when it costs them seven dollars on each hundred that they lend for one year. If all the banking business in the United States could be done at the same percentage of cost as the ten large banks in New York City, Mr. Hill shows that the annual saving to be divided between the banks and their customers would be upward of $53,000,000 in a single year. Of course, no such economy is possible under any conditions of banking over a widely extended territory, but it is certain that the percentage of expense could be largely reduced if branches were allowed. In fact, it is this saving of expense that has caused the great extension of branch banking in Canada, in the British Islands, and on the continent of Europe.

An objection urged against branch banks is that they will draw away all the money from the small towns and use it in large cities. This objection is not in harmony with the one which says that the large city banks will send so much money into the small towns through the branches and will lend at such low rates that existing banks cannot make a living. We might leave these two classes of objectors to neutralize each other, but my opinion is that the flow of capital to and from the small town under the branch system will bear pretty close relation to the demand. Bankers use their money to make a profit, they are just as keen to make a profit in a small town as in a large city, and they will neglect no opportunity in one place more than in the other. The object of having a branch is to

make money at the branch. Drawing away money from the small town when there is a local use for it would soon bring the branch to an end. Its depositors would leave it, and presently Mr. Witham, or somebody else, would establish a branch there to be conducted on more rational principles. My belief is that more money would go from the large city to the small town through branches than goes now in the shape of rediscounts of the paper of independent banks. I think so because the city bank will have confidence in the judgment of its own agent at the branch, and will follow his advice, and because it will get all the profit on the loans made there, instead of dividing it with the independent bank; and also because it will desire to extend its business and get new customers.

A third objection against branch banking urged with some plausibility at the present time is that, if it is permitted, all the banks will be consolidated into a gigantic trust, so that nobody can get any money except on terms dictated by a few powerful magnates. In reply to this we might point to the examples of other countries where branch banking has full swing. In Canada, in Great Britain, in France and Germany, there is not the smallest sign of a "money trust," although trusts and monopolies in other trades are plentiful. On the contrary, the sharpest rivalry exists in the competition for deposits and for loans and discounts, and the rate of interest there tends downward rather than upward. This happens, too, in countries where note issuing is a monopoly by law. It is a monopoly in France; yet that is the country which has the lowest interest rate, and in which the rate is most uniform to all classes of borrowers in both city and country. Note issuing is almost a monopoly in England and Germany, yet we never hear of anything like a money trust in either country. The truth is that money cannot be monopolized. The money in the banks does not belong to them. It belongs to the depositors for the most part. The trust companies, the savings banks, and the private bankers would no doubt be glad to hear of the intention of the regular banks to discontinue the lending of money, or to put up the rate of interest on loans. They would cheerfully fill the vacuum. So, too, would the agents of foreign banks. Fortunately, there is no protective tariff against money. We admit gold free of duty. We allow Canadian banks to have branches in the United States, as many as they like. It is one of

the queer features of our system that any foreign bank can have branches here, but our own national banks cannot. Another curious fact is that state and private banks may have branches here, while national banks may not. I received in my mail a few days ago a circular from the Colonial Bank of New York, with a list of five branches. The greatest oddity of all is that if this Colonial Bank, with its five branches, desired to enter the national system, it could do so and still retain its branches, for the law expressly authorizes that.

Let us dismiss the thought of a consolidation of banks and a money trust as a consequence of branch banking. Money cannot be monopolized. Every village has its private money lenders competing with banks in "shaving notes." You might as well think of monopolizing the water of the Mississippi River by building a dam at St. Louis, as to monopolize money by a combination. You never could get an agreement of bankers to attempt it, and if they should do so the combination could not last a week.

Another argument against branch banking, a sort of corollary of the one preceding, is that it tends to subvert free institutions. I have read with attention a recent speech by Mr. McAshan, of the South Texas National Bank, on this subject. He gives us an interesting discourse on governments, ancient and modern, monarchical, oligarchical, and democratic, and tells us, in so many words, that "branch banking and asset currency is one move in the general direction of usurpation of privileges, concentration of wealth, monopoly of money, and eventually the control of the government and the pauperizing of the people." But if money cannot be monopolized—and I have already shown that it cannot—Mr. McAshan's fears are groundless and our liberties are not threatened in that way. The money power may be a present and growing danger in this country by distorting our vision, lowering our ideals, and setting up a golden calf, instead of Almighty God, as the object of daily worship, but the money power is not the same thing as bank power. The money power resides with the man who has the right to draw checks on the bank, not with the one who pays them.

Branch banking and asset currency are grouped together by Mr. McAshan. Although there is no necessary connection between them, I acknowledge that they are very helpful to each other. They

fit together very nicely, and I am in favor of both. However useful branch banks may be as channels for the distribution of capital, they are still more so as instruments of credit. A Scotch bank with one hundred branches does not divide its capital into one hundred parts. It lends its notes at the branches and redeems them at the head office. Local redemption is dispensed with, and is, in fact, quite unnecessary. Economy of capital, of time, and of labor are here conjoined, but this would not be possible without practical freedom of note issue. A Canadian bank may receive deposits in Halifax to-day, and lend them in Winnipeg to-morrow, because it can issue its notes promptly at the latter place. If it were obliged to wait till it could transmit the money from Halifax by express, time and interest would be lost. If it could not issue its own notes without first buying bonds, lodging them in a government office, and "taking out" currency, the entire profit of the loan might be dissipated.

The principal defect of our national bank system is the rigidity of its note circulation. In a broad sense, the volume of notes is regulated, not by the wants of trade, not by the amount or kind of commercial paper offered for discount, but by the market price of United States bonds. Even if the bonds were sufficient in amount and satisfactory in price, the note circulation would still be lacking in the elasticity which should characterize a good system. By elasticity is meant the capacity to increase or diminish in volume in accordance with the needs of the community, and simultaneously therewith.

Note issuing is, to the banker, simply a question of profit. When he buys bonds and deposits them in the treasury as security for circulation, he virtually buys notes from the government; and his question is whether he can get more profit by such an investment than by using his capital in other ways. His gains arise only from the average amount of his notes which the public will take and hold. There will always be some notes in transit to Washington for redemption and thence back to the bank; and after they come home they will remain unused for a while. During this period they are unproductive capital. Therefore, the banker will take from the government no more notes than he thinks he can keep in circulation. He will hold none for emergencies.

In every country the alternations of seed-time and harvest have a marked influence upon the currency movement. During the spring and early summer, when the farmers are engaged in planting and tilling their crops, they usually incur debt to the country merchants for household supplies; and the currency movement is then sluggish. When harvest comes, a great deal of work must be done within a short space of time, and this requires a large amount of currency to pay the wages of laborers and to meet the various claims against the farmers which then mature. These seasonal demands are imperative. They come simultaneously in large sections of the country. Every other demand for currency is secondary to this, since the only time to harvest the crops is when they are ripe.

The annual crop movement in Canada is marked by an expansion of the note circulation, while no such thing takes place in the United States. What occurs among us is a movement of the currency itself from one part of the country to another, or from the commercial centres to the farming districts, and a reverse movement after the bulk of the autumnal grain and cotton is sold and housed. This money has to be carried long distances and guarded at considerable expense and with loss of interest, and these costs fall upon the agricultural community, since the work of moving must be compensated out of the things moved. In Canada it costs nothing to keep bank notes in the bank's vaults from one crop-moving season to the next. Accordingly, they are always on hand at the places where they are wanted.

Our national bank currency not only fails to meet the varying demands of the seasons, but fails to keep pace with the nation's growth in population and commerce. The volume of bank notes reached its maximum, $358,742,034, in 1882. Then it began to shrink. In 1892 it had fallen to $172,683,850, or about one-half the sum outstanding ten years earlier. In 1893 a rise began and continued till 1900, when it was accelerated by a change of the law, which authorized an addition of 10 per cent. to the currency issuable on the security bonds. The net amount was thus brought up to $323,863,597 on September 30, 1901, which is $30,000,000 less, however, than the amount in circulation twenty years ago. Now a fresh decline has begun. Banks are allowed to retire their circulation at a rate not exceeding in the aggregate $3,000,000 per month.

Nearly $17,000,000 has been thus retired during the six months ending March 31, 1902.

Within a comparatively brief period the bonded debt of the United States will in all probability have been wholly redeemed and canceled. It is not likely that the nation will continue for an indefinite period to pay interest on a debt of which it might easily pay the principal. Such a policy would be unjust to the taxpayers, and could not fail to meet public condemnation. So the problem is not merely how to make note issuing under the present system a little more profitable, but how to keep the system going at all. It cannot be done, except by using other securities than United States bonds. To use inferior securities, like municipal, or railroad, or "industrial" bonds, would require the exercise of discrimination on the part of public officers in the selection of them, and would thus open the door to political influence in making the selection. Moreover, the best judgment of the most impartial Comptroller of the Currency would at times be at fault, as was frequently the case under the state systems of bond-secured currency before the civil war. How to meet the approaching crisis is the chief banking problem of the present day. Any plan for obtaining a real credit currency—a currency based upon the assets of the banks—must have regard to the traditions, habits, and experience of the American people. The smallest change consistent with the end to be achieved will be the one most likely to succeed.

Many plans for securing the needed change in our system have been proposed. The best of these is the one presented by the Indianapolis Monetary Commission. Under this plan bank notes are to be a first lien on the assets of the issuing bank, including the personal liability of the shareholders. The superior claims of noteholders over the depositors of a bank rest upon the fact that the societary movement cannot go on without a currency, and that the very term "currency" implies that whatever passes from hand to hand shall be accepted without hesitation or dispute. This cannot be the case with a bank note if there is any doubt about its goodness. Therefore, the first step to be taken by a government which authorizes the issuing of notes to circulate as money is to provide that they shall be worth what they purport to be. The government has so provided in the existing law by requiring that a sufficient portion of

the assets of each note-issuing bank shall first be set aside and held in the Treasury for the redemption of its notes. If the preference given to noteholders in the Indianapolis plan is regarded as an injustice to depositors, the same injustice exists under the terms of the present law.

The goodness of the currency is still further secured in the Indianapolis plan by a bank-note guaranty fund equal to 5 per cent. of all the outstanding circulation, to be held in the treasury for the redemption of the notes of failed banks. A guaranty fund of 5 per cent. on the present circulation of national banks would be upwards of $15,000,000. The total circulation of banks that have failed during the forty years that the system has been in force has been only $23,559,915. The assets of these banks, including the contributions of shareholders, have yielded this sum, minus $1,352,-612. A guaranty fund of one-half of 1 per cent. would have covered this loss.

If the fund is at any time reduced below 5 per cent. of all outstanding circulation, the Comptroller of the Currency is to make an assessment on the banks, in proportion to their notes, to replenish it. The plan contemplates the substitution of the guaranty fund in place of the existing bond security, by the gradual withdrawal of the latter, so that at the end of ten years from the passage of the act no bond deposit shall be required. The existing provision of law, by which all national banks are compelled to receive the notes of other banks at par in the payment of debts to themselves, is to remain in force; also the provision by which the government is required to receive bank notes at par for all public dues except duties on imports. The proposed bill repeals that portion of the present law which provides that national bank notes shall be received at par for all debts owing by the United States. Therefore, every holder of a failed bank note can pay it to the government at par, and the government cannot pay it to anybody without the consent of the payee. The significance of this part of the Indianapolis plan evidently did not impress the framers of it, since their bill disclaims government responsibility for the notes beyond the proper application of the funds and due enforcement of the remedies provided; but since the government itself will in practice be the last holder of every note which falls below par, such disclaimer is meaningless.

No person or corporation could lose anything by such notes, nor could the government itself lose by them. Ordinarily it would pass the bank notes received in the course of business on to the Redemption Bureau at Washington, and there obtain legal tender money for them. Any failed bank notes received would be passed into the guaranty fund, where legal tender money would be obtained for them. In case of a deficiency in the latter fund, the power of requiring fresh contributions would remain; but the experience of the past assures us that no such deficiency would occur.

Objections to the Indianapolis plan based upon supposed danger of loss to noteholders are groundless. Even if the rascals should take advantage of the law to start sham banks, in order to put out notes and then abscond with the proceeds, the means which the government would have for self-protection would be indefinitely greater than any governmental powers in existence during the Suffolk Bank period in New England. And yet the total losses to noteholders under that go-as-you-please system were only $877,004 in twenty years, and would have been covered by a tax of one-eighth of 1 per cent. per annum on the average circulation outstanding. Anybody who objects to the Indianapolis plan is bound to offer a better one, since the present bond-secured system of note issues is doomed.

The advantages of branch banking are briefly these:

I. Other things being equal, two banks joined together are stronger than one, and three are stronger than two. Branch banking is not a guarantee against bad banking and internal rot, but it is a protection against accidents and external calamities. It is another illustration of the familiar proverb, "In union there is strength."

II. For this reason the public have greater confidence in a union of banks than in the same number of banks taken separately. Branch banking would, therefore, improve the credit of the banks so allied, and increase their deposits. This advantage would accrue more particularly to the branch bank, or the small country bank taken into the system, than to the parent bank in the city.

III. Branch banking would reduce the total expense of banks, and this saving would, in the long run, be shared with the bank's customers in the form of lower rates of interest.

IV. Branch banking would tend here, as in other countries, to

uniform rates of interest between cities and the rural districts.

V. Branch banking has the advantage that it can be extended to places too small to support a regular bank, which requires a full complement of officers and a reserve of coin or greenbacks. Offices, or agencies, can be established at places which are now wholly destitute of bank facilities, but where some deposits could be obtained and some safe and profitable business done, if the public were assured that the parent bank was a strong institution.

VI. Branch banking affords facilities for communicating knowledge of the relative needs of business in different places and for responding to them. Knowledge of the demand and supply of money would be quickly conveyed from the branch at the small town to the parent bank in the city, and funds could be quickly transferred to the branch, either from the parent bank or from any other branch where the demand was less pressing and vice versa.

Remarks by Henry W. Yates:—

THE subject of branch banks, upon which I have been requested to give my views at this gathering of bankers, is, I think, of much greater importance than is generally realized. I must admit, however, that I have been somewhat disturbed from the outset at the position I shall be compelled to occupy in discussing it. Many of the most eminent bankers and financiers have declared themselves in no uncertain terms as being in favor of the adoption by the United States of this system of banking. Some of those so grouped are men for whom all bankers entertain the highest respect, and whose opinions upon financial subjects most of us have been willing to accept as correct. To go adverse to them now requires no small amount of courage, if, indeed, it may not be called presumption. My convictions, however, upon this subject are so strong and decided that I shall not hesitate to show to the best of my ability wherein I believe these men are wrong, and that if they succeed in accomplishing what they propose it would be disastrous to our existing banking system and against the best interest of the public.

We cannot as bankers be blind to the events which are occurring in the commercial and industrial world—events which seem to change entirely the manner in which these affairs have heretofore been conducted. We cannot expect that our business will remain

unmolested when there is a whirl of change going on all around us. The most conservative among us, recognize the situation, and old and young alike are prepared to receive new ideas and to take in all the improvements upon the old ways of doing business, so that we may be fitted to work out our part in the great transformations. We are all conscious of the weakness which prevails in our banking system and we are desirous of having it removed and the system strengthened and improved in any manner that good judgment and wise experience will dictate. But it does not follow from this that we should conclude that our banking system is so utterly bad, that the only remedy for the situation is its entire extinguishment and the creation in its place of another system. This is what I believe would result from the passage of a law which would establish among us the monarchical British and continental systems of large central banks with numerous branches.

The bank of Kansas City, for instance, might very properly be permitted to maintain branches at its stockyards town, and the same would be true at St. Joseph and Omaha. The plan might be expanded so as to permit country banks to maintain branches in towns and hamlets within the limits of the same county. Such an arrangement as this would be fair between banks and beneficial to the public.

There are, however, no limitations of this character in the bill which was recently reported and recommended for passage from the banking and currency committee of the House of Representatives. This act authorizes the establishment of branches anywhere in the United States, its colonies, or in foreign countries.

Mr. Fowler, the chairman of the committee, announced a few days ago that over 1,000,000 copies of the bill, together with a circular advertising its merits, have been distributed throughout the country wherever they would do the most good. A campaign of education in its favor has been inaugurated, which is to be prosecuted at the expense of the general government, and no means will be spared by the powerful combination working for it to accomplish the passage of the act.

Under this law any large eastern bank can establish a branch, for instance, here in Kansas City, and take from the men who are engaged in the business the results of years of toil and devotion. It

does not help the case to say that the Kansas City banks may in a like manner prey upon their smaller neighbors in the surrounding towns and villages.

In opposition to the statement that the branch system would destroy the existing system of independent banks, the committee publishes a letter from Mr. E. S. Clouston, general manager of the Bank of Montreal and president of the Canadian Bankers' Association, in which he says that the statement is fallacious and that there are many Canadian instances which prove the contrary. Upon this most important phase of the question the committee itself has nothing to say except to brand the statements as being "superficial stock statements usually put forward by those who are utterly unfamiliar with this subject," and closing with, "We submit that traditional prejudice and selfishness shall give way to reason, experience, and common interest of the whole people."

Calling names is not argument under any circumstances. Those who differ from the committee's conclusions may be just as unprejudiced and unselfish and have just as great a regard for the public interest as those who support them. It is not my purpose to consider the conditions prevailing in Canada, which Mr. Clouston asserts make it possible for the two systems to exist alongside of each other. I do not know anything about Canada, although judging from the noise which has been made concerning the superior merits of the Canadian system, it comes somewhat as a surprise to be told that any other kind of banking is tolerated here. They doubtless know in Canada what is best for them—what we want to know is, what is best for the United States?

Against Mr. Clouston's statement, who admits that he speaks from the standpoint of a Canadian banker and does not know whether the branch-bank system would be successful in the United States or not, although he says "he should dearly like to make the attempt," we have the statements of prominent American writers and thinkers upon the subject who concur in the belief that the branch system proposed in the Fowler bill would result in the elimination of the existing system of independent banks. This concurrence may be fairly inferred from the utterances of some of the advocates of the branch system.

For instance, Hon. James H. Eckels is one of its strongest

advocates. He recommended branch banks in his Comptroller's report of 1896, but in his plan they were restricted to cities, towns, and villages where a national bank did not exist. This, of course, rendered them harmless.

Professor Charles F. Dunbar, in a paper upon the national banking system, reprinted for use in Harvard University, also endorsed the system, but he would restrict branches to state limits.

Professor J. Laurence Laughlin, in his report of the Indianapolis Monetary Commission, also favored branch banks. He was decided upon the question of monopoly, but declared this would be no valid objection to them—that, to use his own words, "Even if independent banks must disappear in the face of the new system, this could only come about through the elimination of the institutions less fit to perform given services for the community at least cost to it." Professor Laughlin welcomes the monopoly and believes in it. The conclusions of writers like Professor Laughlin are based solely upon theoretical grounds. They discuss the question from that standpoint alone, and give no consideration to any practical difficulties connected with it, for the reason, perhaps, that having had no experience in the business, they do not discern the difficulties.

Practical bankers, however, must instinctively realize, when their attention is directed to the subject, that if this amendment becomes a law, the independent banks must go—not for the reason suggested by Professor Laughlin, that they would be the least fit to live, but because they would be legislated out of existence. The advantages which the branch banks would possess under the law would be sufficient to guarantee their success in competition with the existing system of banks. I will name some of these advantages:

Every bank under the existing system must be provided with some capital. It is demanded by law and also by necessity in order that it may supply a guaranty in attracting deposits. A bank without capital would be shunned by depositors and would soon be forced out of business. The branch banks, on the contrary, would have no capital and would need none. They would be able to obtain credit and transact business upon the capital and the credit of the parent bank, the capital of which would naturally be much larger than that of a local bank.

The capital of the independent bank is taxed like other property. It must stand its fair share of the public burdens. The branch banks would pay no taxes. Under the national currency act, the shares of bank stock can be taxed only at the place where the bank is located, which would be the domicile of the parent bank, and the branch having no capital, there would be nothing to tax.

These two features alone—freedom from capital and from taxation—would seem to settle the question against the independent banks and make it unnecessary to refer in detail to other advantages which the branch banks would possess among which are the better facilities for obtaining collections, for loaning money, and freedom from the requirement to maintain a fixed reserve against deposits.

But it may be thought by some one that granting the fact that the independent banks would not be able to compete with the branch banks, yet the system would be free and the independent banks could secure advantages by organizing under the act. A very slight consideration will show that this would be practicable in comparatively few cases.

The habits, tastes, temperament, and education of the independent bankers would unfit them to become the mere employees of a board of directors perhaps a thousand miles away. The managers of these branches, as stated by Mr. Clouston to be the case in Canada, are usually men trained from boyhood in the service of the banks. Our bankers as a rule do not possess these clerical attainments. They are generally men who have acquired some capital to start with in some other line of business. They may have been merchants or cattle dealers or what not, and the experience gained in this manner has been of far more practical value to their banks than would have been the possession of any amount of clerical ability. They have proved to be excellent drivers for the simple machines they have been running, but they would make indifferent cogs in the complex mechanism of the branch-bank system.

Others may believe that even if the branch-bank bill becomes a law, it will be impossible to put the system into operation to the extent suggested. It may be pointed out that no disposition has been shown by large banks in the past to establish branches—that the difficulty which exists for obtaining proper local management would defeat the purpose. Without doubt, this difficulty is a serious

one and has had its influence in preventing extensions heretofore, but the experience of the past in this respect cannot be considered in this connection. Both our national and state laws have practically prohibited branch banks. If anything of the kind was attempted, it could only be done by organizing separate banks under the ordinary forms and requirements of the banking laws prevailing. I do not think that many of the old and successful banks in the eastern cities would indulge in branches, no matter what the inducements offered might be. But if these banks are authorized in the manner proposed, concentrated capital will see to it that the plan will not be a failure. If existing banks refuse to take advantage of the privilege, other banks will be organized especially for the purpose.

I have endeavored so far to make clear the following points: The branch-bank system if adopted as proposed will destroy our existing system of independent banks. Our existing banks will not be merged into the new system. If the bill becomes a law, the system proposed will go into operation. It now remains for us to consider the theory upon which the plan is based and the benefits to be derived from it, which in the opinion of its advocates will justify the radical action proposed.

There are two words which we hear frequently nowadays when our financial problems are discussed: "elasticity"—for circulation, and "fluidity"—for capital. This "fluidity" for capital is to be realized by means of the branch-bank system. Money, it is thought, will flow naturally and automatically, without friction and at a minimum of cost, from one section of the country to another, and the power of the whole system may be concentrated whenever the occasion calls for it. It is a plausible and attractive theory. Attention is always directed at the beginning of the argument to the practice and experience in other countries where the branch system has prevailed with success.

This kind of argument has its merits, but is it a good one in this case? We might with equal force declare that because nearly all the great governments in the world are monarchies, therefore monarchies are superior to republics. The business methods prevailing in these countries and the circumstances attending them are entirely different from those which prevail with us. It has not been our custom to look to these countries for examples to guide us in

our mercantile and industrial methods—why, then, should we attach so much importance to their financial methods?

The main advantages asserted for the system are as follows: The security of a strong banking credit which will prevent and control panics. The extension of banking facilities into localities unable to supply the capital required for banks. The lowering and equalizing of the interest rate.

All of these things are of great importance, but there are other things in this connection of equal or greater importance to be considered. If in order to secure certain advantages these other things are threatened or endangered, it would be well to halt before the step is taken.

The banking business is not a theory, but a fact, and it pertains especially to communities taken separately. It is—what General Hancock said of the tariff—a local question. The business is also a species of trusteeship. It has been said that he is a public benefactor who causes a blade of grass to grow where none grew before. So is the banker, who releases the buried talents, represented by bank deposits, and joins with them other talents of equal power and value. But the master of the talents is the community in which the banker operates. The gains and the profits must not be sequestered or taken away, but diffused in various ways through the community. If taken away to swell the perhaps inordinate gains of some other community, then so far as the master community is concerned, the talents may just as well have remained buried.

This, then, is my strongest plea: branch banks, instead of being elements of strength for the communities in which they would be established, would be elements of weakness—of wasted efforts and lost opportunities. They would bring nothing into the community and would take much out of it. But let us investigate the special claims advanced for them.

Is it certain that they would prevent panics or control them? No panic has ever been occasioned by the failure of country banks or from any cause which had their origin in the country. It has always been the failure of city banks which has brought on the trouble, and there is nothing in this proposed law which will make the city banks any stronger than they are now; on the contrary, there is much to weaken them. Instead of the independent units

which now distinguish our banking system and which to a remarkable degree have borne the brunt of the tempest and survived the storm, when city banks have gone down by the wholesale, we shall have central institutions with their numerous connected branches all going down together, just as rows of bricks will tumble when you overturn one at the head of the line.

Many different views prevail concerning the cause of panics. There are people who believe that they travel in cycles, and that there is some mysterious connection between the numbers of the years intervening between them. But if this were true, we should expect the rule to be universal, whereas as a fact this is not the case, because they occur with greater frequency in the United States than in other countries. One feature pertaining to them is simple enough and will be conceded by all, and that is the manner of their ocular demonstration, which is a struggle to obtain all the money in sight, it being well known that there is not enough to go around. Panics are generally preceded by large withdrawals of money from circulation, the movement having been induced from some plainly discerned action or trade movement. In the United States we have had more of these operating causes for currency contraction and therefore we have had more panics.

For instance, the panic of 1873 was preceded by the contraction incident to the funding of the war debt, and the panic of 1893 was preceded by the heavy exportation of gold, demanded in payment for the unusual amount of American securities which for some reason was thrown back upon our hands. What the reason was for the return of these securities is also no mystery.

Mr. Stickney in his Milwaukee address[1] declared with great emphasis that the fact that the panic of 1893 was experienced only in the United States proves his contention as to the superiority of the foreign system of banking, which prevented the panic from extending to those countries, and he asserts that if we had had this system in the United States the panic would have been prevented here. But Mr. Stickney failed to note another fact which should be considered in this connection. That only in the United States had a political warfare with large possibilities of success been waged against the standard of value which had previously prevailed and

[1] See the address by A. B. Stickney entitled, "The Medium of Exchange and the Banking Function," on page 205.

in whose terms all contracts for the payment of money had been made; that only in the United States was the business of the country paralyzed by the threat of such a far-reaching financial revolution. It was not strange that the holders of these money contracts should throw them upon the market at this particular period when the controversy and its puerile compromises had produced their logical effects.

It is only reasonable to believe that the like circumstances in other countries would have produced like results, branch banks or no branch banks. We have had more panics in the United States mainly because we have had more political interference with business and financial matters, and they probably could not have been prevented by any system of banks.

The wider extension of banking facilities would be desirable. The enjoyment of them by communities which do not possess the capital required for a bank would undoubtedly prove of advantage to such communities, but this feature of itself is not of sufficient importance to justify the sweeping measure proposed. It may also be asked if these facilities could not be as well supplied by branches of banks in the same country or state.

It is probable that the interest rate would be more generally equalized. The loaning business being reduced to a system and the same rules applied everywhere for the grading of credits and valuing of securities, would naturally work to this end. It is possible that the prevailing rate of interest might be lowered, especially if banks are also to be permitted to issue unsecured bank notes—but this is by no means certain. The interest rates which have prevailed for a number of years past in the United States have been very low, and it is doubtful if they could be forced any lower. It would be much safer to prophesy that they would go higher. There would be a less number of competing banks, and their thorough organization would easily permit of combinations to maintain rates.

Having considered what I conclude to be the strongest points advanced in favor of the branch system, I will now endeavor to show some of the merits of our existing system in comparison with them.

Mr. Stickney declared that this is no system at all, and others maintain that it is so weak and decrepit that it cannot be mentioned in comparison, for instance, with the Canadian system, and that it is

at a disadvantage when compared with the banking system of some little South American state, whose people know nothing of gold and silver as money, but possess the inestimable advantages supplied by a central bank and its branches. We will admit that our American banking system is a peculiar one, but it can at the same time be fairly claimed for it, that it is exactly adapted to American ideas and American manners, and that it has accomplished for American commerce and American industry what no other system could ever have supplied for them, or has ever supplied to any other country in the world. This system has been a process of natural growth, not a creation of law. The circumstances demanded banks and the banks came in response to that demand. Let us glance briefly at its history:

The downfall of the "wildcat" banks and some that were not "wildcat" in the panic of 1857 left a disorganized condition for the banking business. The day of specially chartered banks had come to its close, and in most of the states banks could be incorporated only under a general statute applicable to all corporations. Many years passed before there was any state supervision provided for them. The National Bank Act of 1862 supplied the need for banks in the older and wealthier sections of the country, but the minimum of capital demanded was too large for small communities and especially for the rapidly growing states of the West. State organizations were the only means presented for satisfying this need.

As an illustration of what has occurred in the lifetime of a man who may not yet be called old, let me instance the commencement and growth of banking in Nebraska. In 1863 I joined in the organization of what was probably the first national bank west of the Missouri river, and which at the time was the only incorporated bank in the limits of the present State of Nebraska. At that time there were within those limits only seven banking institutions—two of which were in Omaha and three in Nebraska City. Their combined resources would not have aggregated a quarter of a million dollars. Nineteen years afterwards the number of national banks had only increased to ten, but there were 83 state banks. The following nineteen years were years of marvelous development, and in 1901 there were 116 national and 421 state banks, making a total of 537 banks, with aggregate resources of 113.9 millions of dollars.

The ratio of growth in Kansas was very similar to that of Nebraska. In 1880 there were only 12 national banks, but there were 148 state banks; and in 1901 the number of nationals had increased to 119 and state banks to 410, making 529 banks with aggregate resources of 106 millions of dollars.

These figures tell the story of banking in all of our western states, and under no branch system would such growth have been possible. The history has been a continuing one and is so to-day. As the earlier settled portions of our great domain have grown in wealth and population and put away the crude conditions of the pioneer life, national banks have taken the place of the early state banks. But the pioneer conditions have been reproduced elsewhere —have moved on as westward the star of empire has taken its way. The covered wagon of the emigrant has carried with it the embryonic banker, and along with the first store, the first blacksmith shop, the first hotel and livery stable has been the shanty of the first bank.

Educated employees and well-equipped bank managers would have been impossible for the branch-bank manager. The relations established between the banker and his customers would have been impossible for the branch-bank manager. He could not have that liberty of action which has made the success of the independent banker. It is true that the independent banker might not always exercise the care and caution which would be imposed upon the branch banker. At times his sympathies might run away with his judgment and loss and disaster would be the penalty; but where there has been one case with this result there have been a dozen with the opposite result of success and profit which would be equally impossible of realization for the branch banker.

Many of the most successful and prosperous financiers and business men of the country acknowledge that they owe their success to the timely assistance of some friendly banker, who, instead of demanding security or scrutinizing closely the security offered for loan, has shut his eyes to what he knew did not exist and has accepted for his sole security the trust and confidence he reposed in the man. What do such customers as these care about interest rates? They need the money to finance some enterprise from which profits are expected, which will make the interest charge, no matter how large it may be, a mere pittance in comparison. Such instances

as these have been frequent. I have no doubt that nearly all of you can recall cases of the kind in your own experience.

Mr. Mulhall, who is an authority upon the subject, states that in 1900 the banking power of the United States exceeded that of the United Kingdom of Great Britain and Ireland and all Europe put together. The banking power of the single State of Massachusetts is almost double that of Canada, although it has only about one-half of its population. The clearings of the banks of Kansas City alone are almost double those of all the banks of Canada. Judged only by these figures, which indicate the actual work performed and the service rendered, the conclusion is inevitable that our American system of banking, notwithstanding its admitted imperfections, its shortcomings and its weaknesses—which in time may all be remedied—is superior to any system of banking in the world.

This so-called reform in banking is proposed and urged by well meaning men, but men who in almost every case will be found to be guided solely by their environments, and not by any experience obtained along the lines of this strenuous life to which is due the existence of our American banking system. The passage of the amendment proposed, by destroying the harmonious relations which now exist in our banking world and by threatening the existence of our present organized banks, would not only be disastrous to the banks concerned, but would be a national calamity.

BRANCH BANKING

ADDRESS DELIVERED BY WILLIAM A. NASH, PRESIDENT OF THE CORN EXCHANGE BANK, NEW YORK, BEFORE THE NEW YORK STATE BANKERS' ASSOCIATION, AT NEW YORK IN OCTOBER, 1902.

In 1893 I had the honor of being a member of the most important loan committee ever appointed by the New York Clearing House. Within a year, two of the members of that committee have departed this life. The lamented chairman, Frederick D. Tappen, will always be held in the most grateful and admiring remembrance. The opportunities that I had of observing his courage, his sagacity, and his ability were very many, and I am sure his associates will ever

recall the strength and vigor with which he approached the problems that were every day presented to us during that disturbed time. Peace to his honored memory!

The Loan Committee of the New York Clearing House becomes in a financial crisis the center of all the woes and trials of those unhappy seasons. It is by force of circumstances the trusted repository of the weaknesses and wants of the banks, and its sympathies and resources are appealed to day by day. Every morning brings a fresh batch of needs, and the ingenuity of the financier is taxed to apply the remedy and assist in keeping the wheels on the track. I mention my connection with this memorable committee to explain how some of the facts that came to its knowledge in 1893 had the effect of turning my attention to branch banking.

The Clearing House loan certificate, now so famous as an effectual remedy for strained conditions in finance, can, in the nature of things, be used and appropriated directly only by the members of the Clearing House Association. They are issued only to the Associated Banks, and their circulation is prohibited beyond these banks. The outside banks can participate in the help these certificates afford in an indirect way only and not as a matter of right. So long as the Clearing House banks were so disposed, the assistance they received at such times by the issue of certificates was shared with banks connected with them, but this consideration was given as a gratuity and not as a right. The position of the non-member bank thus became one of great uncertainty and anxiety, and I think it will be recalled by every institution that in 1893 was using our Clearing House indirectly and with no right to its privileges, that their situation was unenviable, unsafe, and unhappy. They were the wards of institutions already heavily burdened with their own cares, and anxious to lessen those cares as much as they could. The non-member bank was then in the painful position of existing by sufferance. Their Clearing House representative would willingly have given up the agency, and there were none who were anxious to adopt them, had they been thrown off. This state of affairs continued for several months, when the redemption of the certificates restored things to their normal condition and released the outside banks from their unpleasant situation. Their solvency was in no wise affected or questioned. It was simply their isolation and want

of close union with the great banks that placed them in this unsatisfactory position.

The dilemma in which these banks were placed disturbed me very keenly, as I was connected not only with the Loan Committee, but also with several of these exterior banks, as a member of their Board of Directors. Indeed, the most trying and exhausting financial crisis that I remember was the so-called panic of 1893.

Naturally such experience leads thinking men to devise remedies for the future. The Clearing House machinery has not arrived at its present efficiency without many changes and improvements. Every emergency has added to the skill with which the next one has been handled. To my mind, the lesson of 1893 was the need of additional protection to the non-member banks in financial crises. There were two ways in which it could be done. One was to become a member of the Clearing House Association. The requirements, however, of that membership are, very wisely, made exacting. No bank with small capital or resources can hope for admission to a partnership on an insufficient contribution to its strength, and so the association has fixed a limit which a large majority of the small banks scattered over the city are unable to approach. The other way was by association among themselves; but that could be accomplished only by a union of capital, and for this a large central bank with branches seemed to me to be the only solution.

I am free to say that the branch banking organized by the Corn Exchange Bank is the application of common-sense to a situation, and nothing more. There is no royal patent of ideas in the matter. It is a system such as any intelligent banker could reason out and apply. I grant you that the reasoning-out—the academic portion—was the easier part, and can be communicated to you in this address. But the application of those ideas to existing conditions became a much more serious matter, and here, as always, the practical working is a matter of individual talent, which we all know is so difficult to discover and secure.

The idea suggested by my observations in 1893 was this: As the New York Clearing House then associated all its members together in practically one bank, and unified all the capital and resources to meet an emergency, so it might and should be possible that the very useful small institutions scattered over the city should

be able to rely upon one central bank for their help and support in troublous times; that one bank with sufficient capital should assume to these smaller banks the same position of protection that the Clearing House did to its members. So that the logical position is that branch banking is the permanent extension to small institutions of that support that is given to the Clearing House banks when they join together in financial panics and pool their resources for mutual protection. In 1898 there was passed by the New York Legislature an act authorizing branch banking that is so brief and comprehensive that I will read it in full:

No bank in this state, or an officer or director thereof, shall open or keep an office of deposit or discount other than its principal place of business, except that any bank located in a city of over one million inhabitants, according to the last state or Federal enumeration, and whose certificate of incorporation shall so provide, may open and keep one or more branch offices in such city for the receipt and payment of deposit, and for making loans and discounts to the customers of such branch offices only; provided, however, that before opening any branch office the approval in writing of the Superintendent of Banks shall be first obtained, and no loans or discounts shall be made except such as may have been previously authorized by the Board of Directors. Every such officer or director violating the provisions of this section shall forfeit to the people of the state the sum of one thousand dollars for every such violation.

This act owes its existence to the suggestions of Mr. R. H. McCurdy, president of the Mutual Life Insurance Company of New York, and was framed by Mr. Joseph S. Auerbach, a well-known lawyer of this city. When its terms became known to me, I saw that the opportunity of accomplishing that which was so much needed in the panic of 1893 had arrived. I saw also the opportunity not only for a system for protection in dangerous times, but one for efficiency and economy of operation in all times; and so the bank with which I am connected determined to take advantage of a law so salutary. Other New York institutions are also availing themselves of the privilege of the law, and in due time I look to see the conversion of small banks into branches, and the creation of new branches to go on until every part of the city is furnished with banking facilities of a character strong enough and competent to meet every demand that may be made upon it. The state law, of course, allows the privilege of branch banking to state institutions only. A majority of the small institutions outside the Clearing House are

under the state law. Our method has been to absorb existing banks by the retirement of their capital, and to start new branches in localities where it has seemed to us there was a field for additional banking facilities. We have in this way terminated the corporate existence of seven banks within the limits of New York City and have opened an equal number of new branches, so that at present we have, in addition to the main bank, fourteen branches. You will readily understand that under the New York law a bank with branches is simply a bank which, for the convenience of depositors, opens offices in any part of the city. The capital of the parent-bank applies equally to each branch, and covers the liability to every depositor no matter where he may be located. A dealer in the newest and most remote part of the city dealing with such a branch is as fully protected by the capital as if he was in the center of affairs and doing a large business with the central bank. It is the extension to a myriad of small depositors of the protection of a large capital and surplus that constitutes the leading merit of the branch system. The branch, through the main bank, has also all the advantages of the Clearing House, the value of which franchise is now so highly estimated. It therefore follows that the embarrassments that have in the past attended small institutions in times of financial stress are very much modified and lessened by a legalized system of association, such as is now termed "branch banking."

As bankers you readily comprehend the statements I have made relative to the motive and value of association under one capital, and you must also be alive to the advantages of a central management. I have remarked on the desirability of securing executive talent. All lines of business are engaged in this quest. There is no need of able and energetic men going without employment or good salaries. In our branch systems we are keeping a keen lookout for bright, thinking men, who are desirous of making their way in their business. In the banks which have become branches by giving up their corporate existence, we have been glad to retain every capable man, and practically we have not reduced the force in any of the banks so adopted. When we have created new branches, competent men have been in request and have had the first chance as managers, tellers, etc

The officer of a branch, of course, has a more limited sphere of action than the officers of a bank, but none the less is the requirement of ability and judgment. He has not the care of his reserve, for that is attended to at headquarters. He is not worried by an excess of uninvested funds, and compelled to go down-town to buy paper or find good collateral loans, for his surplus is massed in the main bank and is handled there. This prevents duplication of lines to borrowers, and concentrates the management of unemployed money in one experienced department, rather than commit it to a number of officers who may lack the knowledge that is at the command of large central institutions.

The manager of a branch is expected to do three things—to attract and accumulate deposits, to keep down expenses, and to master the credits of his own customers. The central bank on its part superintends and scrutinizes those credits, and approves or disapproves new lines of discounts, or enlargement of old lines. From each branch it calls daily for a statement of its condition, of the loans and discounts made, the overdrafts, and the differences in cash. The character of the cash on hand is also reported, the new accounts that may have been opened, and those which have been closed, with the reason therefor; also the notes which have been paid during the day. In brief, the main bank knows by the reports of the managers the exact condition of the entire system at the close of business the night before. The superintendence of the central bank goes still farther. There is a thorough method of inspection. Committees of clerks of one branch are detailed to examine another branch, and often in this way the entire bank is completely examined in one day. These examinations are made without notice, and are frequent enough to accomplish the object without being an annoyance. A system of changes of clerks from one position to another or from one branch to another, and compulsory vacation of every employee at least once, and in some cases twice, a year, has been found serviceable in promoting correctness and efficiency. The collection of out-of-town checks is consolidated into the parent-bank, and there they are forwarded to the various correspondents throughout the country, and are thus kept under better observation than if each branch attended to its own work. It is impossible under such

a system of reports and inspection that there should be a duplication of credits or loans.

All this complicated machinery, involving as it does a vast amount of detail, would work badly but for the help of the telephone. The managers of a branch are thus in instant communication with the central office, and consultations are continually going on. How much intelligence and grasp of the system is necessary to a successful working you as practical bankers can easily divine. It is no boys' play, but when organized by experienced banking men the ease with which a vast amount of additional detail can be handled is almost incredible.

I do not know whether I have succeeded in giving you a very clear idea of the process by which the varied interests in diverse branches can be gathered together at one point and directed with ease and success. It is a matter of development and evolution. We have found it to work with facility, but only after a great many experiments and sifting-out of impracticable methods from those which were found to be entirely suitable and efficient. Therefore, when it is asserted that branch banking on paper can be made a very beautiful and symmetrical affair, it is quite true. It is also true that it can be made a success in practice; though here, as said before, the element of personal ability comes in very largely.

It was this view of the matter that led us, in forming the system of branch banking, to depend not on what had been done in England, or France, or Germany, or Canada, but to work out the system here in America; and we did not need to go to books or precedents to discover that a bank with branches is simply one great bank with its sphere of action scattered over a certain area, but controlled and governed as absolutely as if all the clerks, books, cash, and depositors were gathered into one building.

Whether the sphere of branch banking could be extended beyond a great and homogeneous city I am not prepared to say. Theoretically it would seem to be possible, but all of us are familiar with the way theories are sometimes affected by hard and unlooked-for facts, and it is a question in my mind whether local pride, prejudice, interests, and peculiarities will not be too strong for that desirable unity which we find possible in a city where a branch can be visited and

inspected every day, and the managers and clerks are easily observable and mingle together.

Of its favorable working in a great city, under the conditions I have cited, I have now no manner of doubt. It is true that the experiment has thus far been tried under prosperous and favoring conditions. We have been sailing before the wind now for several years. The skies are still bright, but squalls are not impossible, and some day there may be a storm. In these disturbed seasons, which are by no means obsolete because they are out of fashion, the question of how branch banking will ride out the gale has occurred to no one oftener than to the speaker. It seems to me that the dangers to the creditors of the banks have not increased, but, on the contrary, the guarantees given to depositors have been multiplied and strengthened by this union of small institutions under one strong, responsible head. We have not ignored or been unmindful of criticisms that have been made on this new form of banking. It has been claimed that the small local borrower would suffer by the control of a strong and remote central bank, and that the accommodations would be curtailed by the use of funds in larger and more profitable ventures. This is a mistake and a fallacy. The small loans are very often the best; certainly the risk of loss is limited, and the rates paid for money are higher than in the centers where the dollars most do congregate. I can compare the funds placed at the disposal of the main bank by the branches to an army held in reserve for help and assistance at points where it is most needed. At times one branch makes heavy demands for money; again it contributes largely, and some other department gets the use of its unneeded funds. The ability to move money to points where a good demand exists is certainly an improvement on the old system which I have described as existing in 1893.

ASSET CURRENCY

ADDRESS DELIVERED BY HORACE WHITE, FORMERLY EDITOR OF THE NEW YORK EVENING POST, NEW YORK, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW ORLEANS, NOVEMBER, 1902.

YOUR Executive Committee has asked me to say a few words here on the subject of "Asset Currency and Branch Banking." My views on the latter subject were presented at some length at a bankers' convention in Kansas City a few months ago,[1] and as they were published in several bank periodicals, it would be needless to repeat them now. At Kansas City I spoke in favor of the plan of asset currency proposed by the Indianapolis Monetary Commission four or five years ago. That plan was introduced in the House of Representatives in 1898, but was not brought to a vote or to general debate. A modification of it was introduced in the House by Mr. Lovering of Massachusetts two years later, but was not acted on. A bill embodying the principle of asset currency, but differing in important details from the Indianapolis plan, was reported by the House Committee on Banking and Currency on the 5th of April last. This is known as the Fowler bill. It is the one which now, for the most part, engages the attention of those persons who give any attention to the subject at all.

Before going further, we had best tell what we mean by asset currency. This is a phrase peculiar to our own country. Properly speaking, all bank notes are asset currency, since their goodness depends upon the assets of the issuing bank. This is true of our own national bank notes, since the bonds deposited in the treasury as security for them are assets of the issuing bank. So the distinctive feature of asset currency, as we use the term, is that the bank itself holds all the assets on which the goodness of the notes depends, instead of depositing some part of them in the public treasury. The reason for lodging a portion of them in the treasury is to guard against loss through bad investment, fraudulent management, or robbery. These banking risks exist always and everywhere. Yet asset currency prevails in all civilized countries except the United States and that part of Great Britain called England. It exists in Scotland and Ireland, as well as on the continent of Europe. Bank notes secured by assets not under the control of the issuing bank are the very rare exception to a general rule.

[1] See the address by Horace White on "Branch Banking," on page 254.

I shall first glance at the Fowler bill.[1] I am glad that Mr. Fowler is here to speak for his own measure, because he is well equipped for that task. He and I have discussed his plan together, both verbally and in writing. While entertaining high opinion of his abilities and sympathy with his aims, I have not been able to give entire approval to the details of his measure, and this has been a source of keen regret to me because we have fought battles together for sound money these many years.

By the first section of the bill a division of banking and currency is established in the Treasury Department under the charge of a board of three comptrollers. There is already a bureau of this kind in the Treasury Department under the charge of a single officer. The difference between the one now existing and the one proposed, so far as the bill itself enlightens us, is simply a difference in the number of persons to be consulted in reaching decisions. I can see no more reason for having three Comptrollers of the Currency than for having three Secretaries of the Treasury, but I admit that this is not a very important matter.

The second section provides that if any national bank shall assume the current redemption of an amount of United States notes equal to 20 per cent. of its paid capital, it shall have the right to issue circulating notes, not secured by United States bonds—to issue them at various times, in varying amounts and at varying rates of taxation. I shall not occupy your time with the details of issue. If a bank with a capital of $100,000 shall assume the current redemption of $20,000 of the existing greenbacks, it shall have the right to issue, at certain intervals of time, $100,000 of its own circulating notes; but all the notes above $60,000 are styled emergency circulation, and are made subject to a tax heavy enough to make it certain that they will be issued only in time of trouble, and will be retired as soon as the emergency passes away. In order to identify the United States notes that each bank shall currently redeem, they must be stamped on their backs with the name and promise of the particular bank. So if all the banks should join in the arrangement, there would be upwards of four thousand particular lots of greenbacks in the country. They might be in circulation, or they might be in the banks' reserves or in both. It is doubtless the intention of

[1] See House Bill No. 13363, 1st session 57th Congress.

Mr. Fowler that they shall be mostly in the vaults of the banks responsible for them, and thus it would come to pass that the bank reserves would be composed of bank liabilities to the extent that these stamped greenbacks were held by them. I confess I do not know what the effect of such an arrangement would be in a time of great stringency, when the banks should be compelled to pay out their reserves, or in case of a large exportation of gold. The government's responsibility for these notes is not changed by the bill. It must still redeem them on demand, but having done so, it may demand redemption of them again by the bank. Thus, in an imaginable case, there would be a stream of stamped greenbacks issuing from the banks, flowing to the treasury, and back to the banks, and being redeemed twice in the circuit, and then repeating the circuit. If gold were wanted for export, this would be the most likely method of obtaining it, since by presenting the notes *en bloc* to the treasury the holders would be spared the trouble of sorting them. But, as I said before, I do not know what would be the consequence of having the banks' reserves composed in part of their own liabilities, and I do not venture to make predictions. The plan might work well, or it might not.

Each of the banks entering into this arrangement is required to present to the treasury its quota of United States notes to be stamped as aforesaid, and at the same time to present one-half as many more to be redeemed by the treasury and canceled. The capital of all the national banks will soon reach $700,000,000. If all should enter into the arrangement the amount of greenbacks endorsed would be $140,000,000, and of those redeemed and canceled $70,000,000, leaving $146,000,000 outstanding. The amount of gold in the redemption division of the treasury would thus be reduced to $80,000,000, and under the existing law the Secretary of the Treasury would be obliged to restore it to $150,000,000. The bill provides that when the banks shall have assumed the current redemption of $130,000,000 of United States notes no national bank shall pay out any greenbacks not endorsed, but shall present them to the treasury for redemption as fast as they are received in the course of business, and when redeemed they shall be canceled.

Thus if the bill were enacted, and if the banks should avail themselves of their privileges under it, three-fifths of the greenbacks

would, after a while, be retired and canceled, and the other two-fifths would be locked up in the bank reserves. To those who think, as I do, that all of them ought to be retired and the government taken out of the banking business wholly, this arrangement is objectionable only because it adopts circuitous and dilatory and roundabout instead of plain and direct methods. Why should the banks "currently redeem" notes which they never issued? Why should not the government redeem, both currently and finally, notes which it has issued, and for which it has received value, and which it is abundantly able to redeem? The answer to these questions is found in the report accompanying the bill. It tells us that one of the purposes of the bill is "to protect the national credit against assault through the demand obligations of the government, by completely relieving the treasury at once of a burden amounting to more than seven hundred millions." Protecting the national credit against assault, as the phrase is here used, means preventing the holders of greenbacks from presenting them for redemption. There are only two conditions under which the public will present greenbacks for redemption. One is where there is a legitimate trade-balance calling for gold for export. The other is where fear exists in the public mind that the government may be either unable or unwilling to redeem its greenbacks.

In the former event the trade-balance must be paid anyhow. Such balances are relatively small, and it is desirable that the government, rather than the banks, should furnish the amount needed: first, because the government, not the banks, owes the money which the greenbacks call for; second, because every dollar of gold taken from the banks depletes their reserves and lessens, by as much as four dollars, their ability to make advances to the business community.

In the other event—that is, in the case of a panic—neither this measure nor any other can prevent a run on the treasury for gold, since the government is the ultimate sponsor for all outstanding greenbacks, whether they are stamped or not. The bank depositors, if they are really alarmed, as they were in 1893-6, will possess themselves of the stamped greenbacks and present them to the treasury for redemption. Moreover, the government ought not to be relieved of the necessity of redeeming its demand notes. The onus of redemption ought to be kept constantly upon it. Nations learn

wisdom by experience. They seldom learn financial wisdom in any other school. The repeal of the Sherman silver act was brought about by acute suffering. President Cleveland might have lectured Congress till he was black in the face; he could not have accomplished the purpose for which he called the extra session in 1893, had not bankruptcy been wielding its lash in business circles all over the country. If you want the greenbacks to continue as a permanent feature of our currency system, just devise some way to protect the government from the necessity of redeeming them. If you want to get rid of them you must keep public opinion in a state of anxiety respecting them. I want to get rid of them as soon as possible, because they are political money; and any political party that may hereafter find itself in power at Washington may increase the amount to a billion dollars, or any other sum. I can remember a time, not so very long ago, when a political platform demanded that the volume of money should be made "equal to the wants of trade," What did that mean? It meant that the government's printing press should be put in motion and kept going until everybody had as many legal tender notes as he wanted. You may say that the time for such folly has long since passed away. I should be glad to think so, but I have heard as great follies as that advocated on the stump within sixty days, in connection with the coal strike in Pennsylvania. The danger of greenback inflation will last as long as the greenback itself lasts. When it disappears it will be gradually forgotten, like the continental currency and the Confederate currency; but while it exists it will be an ever-present suggestion and impulse to financial madness.

The bill we are considering has a plan for the eventual retirement and cancellation of greenbacks. I have already referred to the clause for the redemption, by the government, of one-half as many greenbacks as the banks assume to "currently redeem;" also the clause which requires the banks to present to the treasury for redemption all the unstamped greenbacks that they receive in the course of business. There is a method also for eventually retiring the stamped greenbacks. It is somewhat intricate. A safety fund equal to 5 per cent. of all outstanding bank notes is established in the treasury for the redemption of failed bank notes. Into this fund is paid also the tax on bank-note circulation and the

interest received by the treasury on deposits of public money in the banks. Whenever the accumulations of this fund from all sources exceed 10 per cent. of the amount of national bank notes existing, the excess shall be applied to the redemption and cancellation of stamped greenbacks, beginning with those last stamped, and proceeding backward in the reverse order of their assumption by the banks. I suppose that the stamped notes would be redeemed by this process at some time, the tax on note circulation being continuous and the duration of the government (as we hope) eternal; but at what time this result would be reached no man can say. No man can say how many banks would come into the arrangement at all.

The bill provides that the United States shall be divided into clearing-house districts, and that each district shall contain one clearing-house, whose charter, to run twenty years, shall be granted by the Board of Control. They are to effect clearings between banks, and perform "such other business and service as said Board of Control may approve." A clearing-house is defined by Mr. James G. Cannon as "a device to simplify and facilitate the daily exchange of items, and settlement of balances among the banks, and a medium for united action upon all questions affecting their mutual welfare." It is a voluntary association, hampered by no rules except those of its own making, and these it can abrogate or change at its own pleasure. Upon this liberty of action its efficiency depends. It is now proposed to make the clearing-houses chartered institutions subject to a board of control in Washington, and also subject to the process of the courts of law. Each bank will have its own twenty-year charter and will be a partner in another twenty-year charter—that of the clearing-house of its district. This looks like a very complicated scheme, but the greatest objection to it is that it cripples the powers of the clearing-house to take immediate action in any given case. Suppose that the clearing-house committee desires to issue loan certificates in an emergency. The Board of Control may not think the emergency sufficiently grave to warrant such a step. Or some bank in the clearing-house district may object, and apply for an injunction to prevent it. Under present conditions, too, the clearing-house committee can suspend any member for any reason it deems sufficient. The nature of such business requires prompt decision; but if the clearing-house becomes a chartered company,

any bank may appeal to the courts whenever any action is taken that is not to its liking, and thus cause delay. But the acts of the clearing-house are generally such as do not admit of delay. If they are not put in force at once they are of no use. The only chartered clearing-house that I ever heard of was the Gold Exchange Bank, which was incorporated under the law of New York in 1867 in order to facilitate the business of buying and selling gold, during the suspension of specie payments. Its operations were those of a bank and clearing-house united. During the Black Friday conspiracy of 1869, it was put in the hands of a receiver by Judge Cardozo, at the suit of a bogus claimant; all clearings were forbidden; and the fees of lawyers and receivers, amounting to $100,000, were paid out of the assets.

Now, why should we adopt indirect methods, instead of direct ones, either to get rid of the greenbacks or to establish a system of asset currency? The straight method would be to provide that the government shall use a certain portion of its surplus revenue to pay and retire its past-due notes, and that the banks shall issue their own notes according to the safety fund plan. There is really no reason why these two things should be coupled together at all. The one is not necessarily contingent upon the other, but when either or both shall be embodied in legislation it is my opinion that they will command more votes in Congress and in the country if they are direct and easily understood than if they are roundabout and obscure.

That asset currency will come, I have not the least doubt. It will come because it will be a necessity. The yearly spasm in the money market, in connection with the crop movement, would force Congress to act eventually, even if nothing else should. Why should we have such a yearly spasm, any more than Canada? She has a harvest time also, but she has no more constriction of the money market in the fall than in the spring. All seasons are the same to her, because her banks can issue their notes in the amounts and at the times and places where they are wanted. The Canadian banks can create the crop-moving currency when it is needed, or rather they can keep it on hand without expense to themselves, and put it out when it is called for. We can do nothing but send it from one place to another, perhaps a thousand miles apart, and send it back

another thousand miles after it has performed its office; and if there is not enough to go around, we must import gold to supply the deficiency.

But there is another force operating to bring asset currency to the front, and that is the gradual extinction of the national debt, upon which the present currency is based. Fifteen million dollars of the bonds of 1925 were taken by the Secretary of the Treasury for the sinking fund a few days ago. The debt is shrinking all the time, and as the amount becomes smaller the market price of the remainder increases. Private investors are constantly bidding against the banks. They are buying bonds out of your own hands. They are making it more profitable for you to retire your circulation than to keep it. This condition will be intensified as years roll on. The basis of bank notes issued on the present plan will disappear, and then asset currency will be a necessity unless we are to have a currency consisting merely of government notes and gold certificates.

Asset currency ought to be better than government notes, because the assets of the banks consist of the circulating properties of the country. If these assets are not good, nothing is good. If they were not good, the government could not long exist. The assets of the banks are partly cash and partly claims upon the producers and holders of the country's wealth of every description. The government has nothing but the right to tax, and this is effectual only in so far as the producing power of the country, in which the capital and deposits of the banks are invested, is profitably employed. France is a rich country, but the Bank of France is much stronger financially than the government, as has been proved in more than one crisis of that country's history. There are other reasons why banks are more fit than the government to supply the nation's currency. They are credit-dealing institutions, lending institutions, business institutions. The treasury, when it issues currency, is simply a borrower, and it can never be anything else unless it attempts to discount commercial paper, which nobody has yet proposed, and which no sane banker would consider possible under our form of government. Although the assets of the banks as a whole are good, it does not follow that those of each individual bank are good. There will always be a certain percentage of bankers so eager for profit

that they will not keep the necessary reserve against their liabilities. Hence there will always be a certain percentage of bank failures. But no system of asset currency which contains the possibility of depreciated bank notes can have any chance of adoption in this country. The failure of one bank, if its notes were not provided for and kept at par, would discredit the whole system, because it would put every noteholder to the necessity of examining the contents of his pocket-book, and scrutinizing all the notes offered to him in trade, and perhaps keeping a bank-note reporter at his elbow to determine the goodness of the paper money in circulation, as was customary before the Civil War. I shall not go into details on this subject—time does not permit—but I consider the Indianapolis plan of asset currency bomb-proof as regards the safety of note issues, and I think that the Fowler bill is also.

There are some superstitions prevailing in the public mind, and in the banking mind also, regarding bank notes. It is commonly believed that it would be dangerous to allow a bank to issue notes exceeding the amount of its paid capital, and that anything above 60 or 80 per cent. of its capital ought to be heavily taxed. Both the Indianapolis plan and the Fowler bill embody this conception. The soundest bank that the country had before the Civil War was the State Bank of Indiana; yet this bank was allowed to issue notes to double the amount of its capital, and it did so, and it never failed to redeem them, even in the panic of 1857.

This is not difficult to understand. The State Bank of Indiana kept the right proportion of reserve to liabilities, and when a bank does so it is immaterial whether its liabilities are for notes, or for deposits, or for a combination of the two. The State Bank of Indiana existed in a sparsely settled agricultural country where deposit banking was of little use. Nearly all the persons whose paper was discounted wanted notes. If the bank had been hampered by a provision that it should not issue notes in excess of its paid capital, and not more than 80 per cent. thereof without paying a tax of 5 per cent. on the excess, it could not have existed at all. Suppose that our national banks were prohibited from having deposit liabilities in excess of their paid capital, and were required to pay a tax of 5 per cent. on all such liabilities above 80 per cent. thereof, what would be the result? According to the last report of

the Comptroller of the Currency, the capital of the National banks was $655,000,000. Under the supposed rule their deposits could not exceed that amount in any event, and they could not exceed $524,-000,000 without paying an excessive tax on the overplus. Yet their actual deposit liabilities were within a small fraction of $3,000,-000,000 at that time, and their loans and discounts were an equal sum. How many of these banks could exist if they were restricted by such a rule regarding deposits? And how could the business of the country be carried on?

Yet, as regards the safety of a bank, there is no difference whatever between a note liability and a deposit liability. The former is a check drawn by the bank's president against his reserve fund, the latter is the check of the depositor, or his right to draw it, against the same reserve fund. Of a given amount of liabilities composed partly of notes and partly of checks, the notes will stay out longer than the checks and give the banker less trouble. Only about one-fourth of the national bank notes now existing are presented for redemption each year.

I might instance the Suffolk bank system that prevailed in New England before the Civil War. This was as distinct an evolution and as marked an example of "survival of the fittest" as can be found in this world's affairs. I never read its history without admiration, and while I agree that the national banking system was necessary and was a great blessing for the whole country, and that the Suffolk system had to give way to it, I regret the necessity that put an end to so useful an institution.

Under the law of Massachusetts any bank might incur debts to the amount of twice its capital stock, not counting as debts its deposits, or its dues to other banks. Therefore the banks might legally issue circulating notes to double the amount of their capital, but practically they could not do so. Their note circulation was seldom more than 40 per cent. of their paid capital. The public would not take any more. It is the public demand, not the inclination of the banker, that determines how many notes shall be in circulation; and this public demand ought always to be satisfied by banks paying out their own notes over their own counters in exchange for good bills receivable. The law of Massachusetts prohibited banks from paying out any notes but their own, and that

was a wise provision, since it compelled the banks to send to the Suffolk for redemption the notes of other banks that it received in the course of business. All the banks were thus required to keep a sufficient reserve in order to redeem their notes at the Suffolk. The New England note circulation was redeemed ten times each year on the average, yet the cash reserve needed was only 15 per cent. of both circulation and deposits, and country banks were allowed to keep all of this reserve in Boston banks. These country banks received as deposits in the course of business as much specie as was ever called for by their customers, and they had plenty of currency to meet all demands, since they made it themselves, as the Canadian banks do now. Yet the losses to noteholders from failures among the 500 banks embraced in the Suffolk system in twenty years (1840-1860) were only $877,327. A tax of one-eighth of one per cent. per annum on the circulation outstanding would have protected noteholders against this loss.

The point of all this is that there is no necessary or logical relation between a bank's capital and its circulation, any more than there is between its capital and its deposits. Both are liabilities, and the same percentage of reserve that will protect one will protect both. Why is it, then, that all of our banking laws and projects of law restrict the note issues of banks to a certain proportion of their capital, while they allow deposits to multiply to any extent? Why is it that bankers themselves see no danger in the unlimited increase of deposits, but look with great favor thereon; yet think that note issues should be restricted to the paid-up capital of the issuing bank, even where they are secured by bonds in the treasury? This queer notion is an inheritance from the days of heterogeneous state bank notes, when banking was in great disorder, and when failures were frequent and disastrous. Banks were known to the public only as note-issuing institutions. Examine the statute books of that period and you will find that the phrase "banking privileges" meant solely the right to issue circulating notes. The words had no other acceptation. The suffering caused by broken banks was, therefore, attributed entirely to note issues. It sank into the public mind. It created the conviction that the banks failed because they had insufficient capital, which was true in most cases; but it did not follow that the notes had caused the failures. On the contrary, the

notes, as long as they were out, brought strength, not weakness, to the banks; and if the latter had been managed rightly in other respects, and had kept the proper cash reserve, as the State Bank of Indiana did, they would have weathered all gales, as that famous institution did, and as the great majority of the Suffolk banks did. We have inherited the beliefs of those ante-bellum days. We have accepted without question or examination the doctrine that the note liabilities of a bank should be restricted to the amount of its paid capital, or to some proportion less than its capital. If this is a sound doctrine, then it is logical to say that all note issues above 60 or 80 per cent. of capital should be termed "emergency circulation" and be heavily taxed. If it is not sound, then the proposed tax is unphilosophical and is really an obstacle to the relief sought for by such circulation.

But it is said that Germany issues emergency circulation in times of great stringency, and puts a tax of 5 per cent. on it, and does so with advantage to the business community and to the imperial treasury. Quite true, but the German bank act measures note issues by the bank's cash reserve, not by its capital. It says that the Reichsbank may issue notes to the amount of 450,000,000 marks, regardless of its cash reserve. Then it may issue additional notes equal to its cash reserve. Up to this point the German system runs parallel with the Bank of England system, but here they diverge. The German law allows further issues, but not to an unlimited amount. The bank must always keep a cash reserve equal to 33 1-3 per cent. of its outstanding notes; and upon this last batch, or overplus, of notes it must pay to the imperial treasury a tax at the rate of 5 per cent. per annum. Thus the danger line is drawn, not at the capital of the bank, but at its cash reserve, which is the true criterion both for note liabilities and for deposits. It is the true criterion because the bank's capital may be locked up in investments which cannot be realized on immediately, whereas the reserve consists of the very thing wanted to meet liabilities.

Before closing, I wish to speak of one feature of the Indianapolis plan of asset currency which has not attracted the attention that it deserves. It provides that the government shall hold a 5 per cent. redemption fund for all bank notes as now; also a 5 per cent. guarantee fund, with the power to replenish it by taxation when needful;

also a paramount lien on the assets of failed banks and on the shareholders' liability, for the redemption of the notes of such banks. Having supplied the government in this way with the means for redemption of bank notes, it provides that the treasury shall receive at par all such notes in payment to itself except for duties on imports, and that it shall not pay them to its own creditors without their consent. Under this plan, therefore, the noteholder can lose nothing, because he can use the notes in payments to the government; and the government cannot lose, because it is armed with the power to recoup itself. It is said by some that if the government is to be responsible for a note circulation it will issue such circulation itself, instead of intrusting that function to banks. That is one of the things that remain to be seen. I suppose that the government will insist upon whatever the people insist upon. It is all a matter of popular education.

EMERGENCY CIRCULATION

ADDRESS DELIVERED BY CORNELIUS A. PUGSLEY, PRESIDENT OF THE WESTCHESTER COUNTY NATIONAL BANK, PEEKSKILL, N. Y., BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW ORLEANS, NOVEMBER, 1902.

MUCH criticism has been made of the currency system of this country; but whatever there is of criticism, our currency is sound beyond question and good beyond peradventure. The great essential in any currency is quality rather than quantity. It is the exponent of value in trade and exchanges, and if it fully meets these demands, the desirability of an abundance of money ceases. One does not need three horses to draw the plow when one will do; and the smallest amount of money which will transact the largest amount of business is a very near approach to the ideal in business connections.

The greatest objection to our currency is that it does not possess flexibility. Its only elasticity is afforded by our mines and the gold settlements of the trade balances for and against us. The present law regulating circulation, whose purpose was not to prevent a too sudden contraction of the currency, but to prevent the govern-

ment bonds held to secure circulation from coming upon the market, prohibits the retirement of more than $3,000,000 per month. It has been suggested by prominent bankers that this law should be repealed, and that banks should be allowed to retire their circulation if they chose to do so. Although this might add flexibility to our currency system, yet I am not sure that such action would be desirable, as it would undoubtedly result in a very considerable contraction of the currency in order to reap the profits to be derived from the high prices of government bonds. Possibly, if inducement in the way of a reduced taxation should be made by the government to the banks to retain their bonds after they had retired their circulation, in order that they might have them on hand to reissue circulation upon as occasion might require, it might add elasticity to the currency.

The national banks of this country are compelled to hold as a reserve, gold and silver and United States notes, and yet I see no reason why a national-bank note, which is admittedly more effectually secured than a greenback or a United States bond, should not be counted as a reserve, because I consider it as good for that purpose, or any other purpose, as any obligation in this country to-day. As a well-known banker has said: "It has first an obligation of the bank to pay; second, it is secured by government bonds; and third, the government is pledged by law to redeem it upon presentation, having in turn a prior lien upon the assets of the bank for reimbursement." In Germany I understand that notes of specie-paying banks are so counted as a reserve.

During the panic of 1893 it was necessary to resort to the issuing of clearing-house certificates, and that they rendered the public untold service is unquestioned. The amount of clearing-house certificates issued by all the clearing-houses of the country amounted in the aggregate to about $66,000,000. These certificates were issued merely in the great commercial cities, and were available only between banks in settling debit balances at the clearing-houses. These certificates were the means of affording only indirect relief, as they were not negotiable in the hands of individuals. If a great panic should again befall the country, I am somewhat in doubt whether these clearing-house certificates might prove as desirable under our changed conditions as in the past. It has been stated

by eminent authority that these certificates, if again issued, might impair our national prestige as a money power in the world of finance and depreciate our securities as a nation.

This being the case, it behooves the bankers of this country, and the legislative bodies, to prepare such an emergency currency as will take the place of clearing-house certificates and relieve the distress which not only attends a great panic, but results from a demand for additional circulation in the moving of the crops and the undue contraction of the currency resulting from the accumulations from customs deposited in the United States Treasury, which occur almost periodically each year.

Various plans have been evolved for the reform of the monetary system, and a number of bills have been introduced in Congress during recent years, for the purpose of giving greater elasticity to the currency. Among the former are the famous "Baltimore plan," the plans of Secretaries Carlisle and Gage, and of the Indianapolis Monetary Convention. Of the bills that have attained prominence are Congressman Walker's, the Lovering, and Mr. Fowler's.

As a member of the Banking and Currency Committee of the House of Representatives, I want to say that Mr. Fowler is worthy of high commendation for the thought and laborious work which he has given to these questions. He has rendered a service by bringing these great problems to the attention not only of the bankers, but of the people of the entire country. Another bill,[1] which has been highly commended in certain sections, which provided for the incorporation of clearing-houses to issue an emergency currency, prepared by Mr. Gilman and introduced by me at the last session, had the same purpose in view. Also a bill prepared by Hon. Willis S. Paine, ex-Superintendent of Banks of the State of New York, which provided for the issuing of currency by state banks.

I do not believe the American people are yet ready for an asset currency pure and simple, or for such a radical departure in our currency system as is provided for in the Fowler bill. Mr. Fowler in his addresses refers to the effect or results of branch banks. He states how money would flow out from the great banks as needed; but he fails to state how money would flow in from the smaller institutions to the great centers, and how the branches of the banks

[1] See House Bill No. 7950, 57th Congress.

of the great cities would eliminate the local institutions throughout the country. These great banks would be able to plant their branches in every city or town where they pleased, and without capital or taxation would soon drive the local institutions out of business. After this has been accomplished, the poor borrowing public, for whom Mr. Fowler expresses such concern, would pay the rate as well as the freight that large institutions would see fit to demand. We do not want a great money power that might become a vast political power in this mighty republic. From such a possibility the American people, every patriot, every lover of his country, may well pray to be delivered.

I believe, however, that an emergency currency, ingrafted upon our present system, might prove beneficial, and would also test the working of an asset currency, to which we may have to come when the government bonds are no longer available as security. Such an emergency circulation, I believe, might be had if the present law should be amended so as to permit all national banks holding government bonds as security for circulation to issue 10 per cent. additional currency on the amount of bonds deposited with the Secretary of the Treasury, the same to be taxed at the rate of 5 per cent. per annum; and also providing that all banks having a surplus fund equal to 20 per cent. of their capital should be authorized to issue 10 per cent. of asset currency, to be secured by approved bonds or by bills receivable specifically set apart for that purpose, as in the Bank of France. As the present law provides that all circulation issued by the government to the banks is a first lien upon assets, there would be no necessity for change of the law in that respect. This 10 per cent. of asset currency should be taxed at not less than 6 per cent. per annum, and the bonds and bills receivable set apart to secure the same should be in excess of the circulation by at least 50 per cent. The bills receivable should have one or more indorsers known to be responsible and guaranteed by the personal bond of the directors that the same are set aside as security for circulation. The setting-aside of the bonds should also be guaranteed in a similar manner, with the infliction of a penalty if the security is not set aside as guaranteed.

These emergency circulation notes should not be printed in any distinguishing color or design, but it should be within the power

of the Secretary of the Treasury and the Comptroller of the Currency to have in hand and to issue such emergency currency, not to exceed 20 per cent. of the bank's capital when in their judgment it should be advisable or necessary, and also to call for payment of this circulation from banks, when it should be desirable that the same should be retired, thus avoiding inflation of the currency, which, in my opinion, might prove more dangerous than a lack of currency at certain seasons of the year. The great requisite should be the quality rather than the quantity. Mr. Dawes, a former Comptroller of the Currency, has very aptly said, "We do not want an asset currency that will help us into a panic when we are out of one, but an emergency currency that will help us out of a panic when we are in one." And better still, and what is needed and required, is an emergency circulation so perfect in its security and availability that it will unquestionably prevent the panic.

If such an amendment to our monetary system should be provided, it would result in sufficient currency, in my opinion, to tide over any conditions of panic or stringency in our circulating medium. It will be remembered that in the panic of 1893 about $66,000,000 of clearing-house certificates were issued. Under the provision that 10 per cent. should be issued by banks having government bonds on deposit, there being about $365,000,000 of government bonds held as security for circulation, an amount aggregating about $36,000,000 would be afforded; and under the provision that banks having 20 per cent. of surplus should be allowed to issue asset or emergency currency to the amount of 10 per cent. I should consider that $60,000,000 more would be available, without having examined carefully into the number of banks that could avail themselves of this provision. The provision that national banks should issue such currency would undoubtedly lead all banks to strengthen themselves, in order that they might avail themselves of the act.

The provision might also be made that this currency should not remain in circulation for a longer period than six months. But this might safely be left to the Secretary of the Treasury and the Comptroller of the Currency, the retirement of the notes being effected, as at present, through the redemption fund, and without disturbing the bonds on deposit. The security of 10 per cent. of

the currency issued would be unquestioned by the market value of government bonds at the present prices and, with the interest charged upon this 10 per cent. of currency, as well as upon the 10 per cent. issued by banks with 20 per cent. of surplus or more, would soon provide a fund amply sufficient to pay any possible loss that might be incurred by the government. The same provision as now in regard to the deposit of 5 per cent. with the Comptroller of the Currency should also apply to the circulation issued under this provision, and I am not sure but that at least the same percentage of legal-tender money should be held against this circulation in banks as is now provided for bank deposits.

A sound, stable, and responsive currency is one of the greatest bulwarks of national glory, greatness, and power, and one which will prove of inestimable value to its business interests.

THE MONEY SUPPLY OF THE UNITED STATES

LETTER ADDRESSED BY JAMES B. FORGAN, PRESIDENT OF THE FIRST NATIONAL BANK OF CHICAGO, TO THE TEXAS BANKERS' ASSOCIATION, APRIL 28, 1903.

"THE money supply of the United States—is it sufficient for our commerce? And suggestions as to a practical plan to increase its elasticity."

From an experience of twenty years, my answer to the question propounded is that the supply of money periodically oscillates between overabundance and inadequacy, in accordance with the demand for it, which varies with the seasons. The supply, being arbitrarily fixed in quantity, bears no relation to the varying demands of commerce, and there is not even an attempt in our monetary system to adjust the supply to the demand.

In the long run, commerce suffers more from the periods of overabundance than from those of scarcity. The origin of each recurring period of tight money can be traced to preceding periods of easy money. Whenever money becomes so overabundant that bankers, in order to keep it earning something, have to force it out at abnormally low rates of interest, the foundations are laid for a period of stringency in the not far distant future; for then

speculation is encouraged, prices are inflated, and all sorts of securities are floated until the money market is glutted with them. Our monetary system is not the sole cause of these alternating fluctuations, but it lends itself to them and is auxiliary to other causes. Our national banking system and the government treasury system also aid and abet them, and the three together are responsible for them. If these three systems, so closely allied, were all adapted and adjusted to the needs of commerce, as they should be, their relation to commerce would be to develop it on a sound basis by establishing steady markets. Their influence would be to prevent rather than to cause such oscillations as now take place between easy and tight money, speculation and stagnation, inflation and depression. At present, however, my remarks are to be confined to the monetary system.

For some years it has been apparent, both from statistics and from financial conditions, that the circulating medium of the country has not increased in proportionate ratio to the expansion of bank capital and deposits, the development of commerce, and the increase of population. Notwithstanding the efforts of the Secretary of the Treasury to keep the different kinds of government money circulating and to encourage national banks to increase their circulation, it is evident that the supply has become inadequate to the requirements of commerce during the season when the maximum amount of it is wanted.

To add to the money now in circulation more of the same kind, until the supply shall equal the maximum requirements of commerce, without providing means for its contraction when these requirements are at their minimum, would only perpetuate the evils of our present system. What we require is a more elastic currency.

Before making any suggestions as to how its elasticity may be increased, pardon me if I go into an elementary discussion of the real meaning. Elasticity, in the currency as in anything else, means of the subject that in some quarters an erroneous idea of the meaning of elasticity exists. The popularly accepted meaning of the word seems to be expansion. This is precisely the reverse of its real meaning of "elasticity." I have gathered from the discussion contraction. To illustrate: If I take a piece of soft gum in my

hands and pull it out, it will expand to the limit of its capacity, and when released will remain expanded. Gum is not elastic. If, however, I take a rubber band in a similar way and expand it, when I let go it will contract. It is elastic. Elasticity is that quality in a substance which enables it to contract when outside pressure on it has been removed. This is precisely what elasticity in the currency is. It is the contraction in the amount of it which takes place when the demands of commerce for it decrease. These demands increase and diminish, are strong and weak, in accordance with the natural and seasonable fluctuations of business. The lack of elasticity in our currency is that when once issued it remains expanded like the gum, and does not of its own accord contract like the rubber band. The amount of it in existence is no less when the demands of commerce are at their lowest than it is when they are at their highest, and vice versa. I know of only one way by which this elasticity, this ability to contract, can be given to it; that is by the daily withdrawal, through the actual redemption and practical cancellation, of all bank notes which are not kept in circulation by the requirements of commerce. When the Bank of England redeems its notes, it cancels, destroys, and does not reissue them. Other banks issuing credit currency, such as the Scotch and Canadian banks, when they redeem their notes, cancel them so far as their existence as any part of the money of the country is concerned, but do not destroy them. They are written off their books and are laid aside for the purpose of being reissued when opportunity occurs. They are, however, so far as their connection with the circulating medium of the country is concerned, as utterly out of existence as if they did not exist at all, and remain so until they are again issued. Under our system the currency which each bank receives from the Comptroller immediately becomes a part of the fixed circulating medium of the country, and counts as so much money. The banks that nominally issue it have a right so to count it, for they paid out actual money for it when they bought the government bonds to secure it; hence, our national-bank notes, instead of being dealt with as mere promises to pay money, are kept afloat in the channels of commerce, and are handled by the banks the same as gold or government notes, and no active redemption of them is deemed necessary. The result is that, when

the maximum demand for currency occurs, so much of it is required that the banks with difficulty maintain their legal reserves; but when the demand is at its minimum, the currency accumulates in their vaults and they resort to forced loans, inflated credits, cheap rates, and other artificial methods, to keep it employed and earning something. Our present specially secured bank currency has no elasticity and can have none. When bank currency is not so secured, it floats in the channels of commerce on exactly the same basis as checks, bank drafts, and other similar obligations and is daily presented along with these through the clearing-houses for redemption. Banks are not likely to pile up in their vaults the non-interest-bearing unsecured notes of their competitors, any more than they will hold over their checks or demand obligations of similar kinds. The competition among the banks to put out their own notes is the prime factor in effecting the daily redemption which alone affords elasticity in the currency. The effect of such daily redemption is to keep the volume of the currency in circulation in exact proportion to the demands of commerce, because such of it as is not required, instead of accumulating in the banks and continuing to count as money, is redeemed and to all intents and purposes canceled. Whatever amount of its own notes each bank has on hand unissued counts for nothing, as they only become a part of the money of the country when they have been paid out. During the season when the requirements of commerce are light, each bank will have on hand a supply of its own circulating notes, counting for nothing, as stated, but in reality an additional reserve strength against the demands of the next active season. The system practically gives to the banks the right to create and furnish circulation just when it is wanted, and promptly retires it as soon as it is no longer wanted.

If I have correctly diagnosed the trouble with our money supply, it follows that we need relief. Where shall we look for it? There can be no doubt that the addition of an elastic currency to our present inelastic supply would afford relief, and in a large measure correct existing evils. Any legislation on the subject must be of an experimental nature, and should therefore be guarded by a law carefully thought out in every detail. To establish a system under which five or six thousand banks, scattered all over this vast coun-

try, will issue their individual circulating notes and have them circulate everywhere at par is no small undertaking. The students of finance may supply the principles; but practical bankers must work out the details. The law should be as nearly perfect, both in principle and detail, as possible, for on the practical working of the details will depend the effectiveness of the system. It will not do for the students of finance to brush aside practical suggestions, as they too frequently do, with the remark: "Oh! that is a mere matter of detail." It will be found that the ultimate success of the system will depend upon its details being properly worked out and embodied in the law before any currency is issued under it. I believe that the privilege of issuing a limited amount of assets currency may be safely granted to national banks under proper regulations.

Mr. Fowler's bill[1] now before Congress is based on correct principles, but is deficient in its details. What it needs is to have a committee of bankers elaborate out of it the details of a practical plan. Without assuming to take the position of such a committee, I will now suggest a few of what appear to me to be improvements in the details of the Fowler bill. The bill is not intended to interfere with the present circulation of the national banks. It proposes, however, to permit them to take out and issue assets currency to an amount not exceeding 25 per cent. of their paid-up capital, without providing for their keeping out their secured circulation in its present volume. It seems to me the effect of this would be that the new bank currency, being more profitable, would soon displace the old. Many national banks have already drawn their circulation down to the minimum required by law, seeing more profit in selling the bonds at the premium they have commanded than in continuing circulation against them. A provision in the bill requiring that every bank taking out assets currency must keep out an equal amount of currency secured by government bonds would not only prevent the withdrawal of the old for the purpose of substituting the new, but in all probability would increase the volume of the secured circulation.

The bill proposes to divide the country into three redemption districts, with New York, Chicago, and San Francisco as respectively the redemption centers of each district. Section 9 of the

[1] See House Bill No. 16228, 2nd session 57th Congress.

bill requires each bank "to redeem its notes on demand in gold coin over its own counter, and if it is located outside the redemption cities it must select a national bank in a redemption city which shall redeem its notes in gold coin." The notes when issued are to be "received upon deposit, and, for all purposes of debt and liability, by every national bank at par, and without any charge of whatsoever kind." The object is to have all the notes of all the banks circulate everywhere in the country at par. An arbitrary law compelling every national bank to receive the bills of all other banks at par would, of course, accomplish the end in view, but at the expense of justice and equity, for it would arbitrarily submit each bank to the trouble and expense of forwarding to the point of redemption the bills of all the other banks, which, it is evident, would, in many cases, prove a severe tax. The natural and equitable way to have the notes circulate everywhere in the country at par is to compel each bank of issue to furnish such ample and easily available facilities for the redemption of its notes that they can never get so far away from one of its redemption agents as to cause them to fall below par in consequence of the expense and delay in getting them redeemed. In Canada until 1890 the notes of the banks in each province were at a discount in all the other provinces, except where the bank of issue established a branch at which it redeemed its notes in the other provinces. This was overcome by a law compelling each bank of issue to arrange for the redemption of its notes in the redemption city of each province. There are seven provinces, and therefore seven redemption cities at which all the notes of all the banks are redeemed; hence they all float at par and are all on an equal footing wherever they may happen to circulate. This is correct in principle and works equitably. Every bank issuing notes which the law compels all other banks in the country, wherever located, to receive at par should be required, at its own expense, to establish such facilities for the prompt and easy redemption of its notes as would enable all the other banks to get them redeemed with the minimum of expense and delay, and the law should provide in detail the necessary machinery for such redemption facilities. There would be no practical difficulty in effecting such an arrangement. We should have at least five districts and five redemption cities instead of three. St. Louis and

New Orleans should be added to the three already mentioned in the bill. Banks outside of redemption cities could easily arrange to have their principal reserve agent in the redemption city of their district appointed as their primary redemption agent, and through it have secondary redemption agents appointed in each of the other four. In this way the notes of the banks in each district, being redeemable in the redemption city of each of the other districts, would circulate on an equal basis with the notes of the banks of those districts, and would therefore pass current at par without any arbitrary legal requirement that they should do so.

Under Section 11 of Mr. Fowler's bill the banks in each district are prohibited from paying out the notes they may receive of the banks in other districts, but are compelled to return them to the district to which they belong for redemption. This principle is taken from the old Massachusetts law when assets currency was so successfully circulated in that state, but it does not seem to me that it would suit existing conditions. It would, I think, defeat one of the principal benefits to be derived from the proposed plan. The largest banks in the country, especially those in New York, would derive little benefit from the system if their circulation were confined to their own district. They would have the right to issue much more than the requirements of their district would call for. At the same time the banks in the South, with their demands for handling the cotton crop, and in the Northwest, with their demands for harvesting and shipping the grain, could, it seems to me, utilize to great advantage the surplus currency of the New York banks. During the spring and summer the deposits of country banks with their correspondents in reserve cities accumulate, and during the active season in the fall are withdrawn. It would be a great relief to the banks in reserve cities, with their large capitalization and correspondingly large ability to furnish circulation, to ship out their circulating notes to be used by the banks in need of them in other districts. Take a transaction as an illustration: Suppose a bank in Minneapolis accumulates during the summer a balance in New York of a million dollars, which in the fall it has occasion to reduce by the actual shipment of currency to $500,000. It would be a great convenience to the New York bank having to ship that currency, if, instead of shipping, as it now does, actual money,

or what counts for actual money, reducing its cash on hand, it could ship its own notes. It would thus simply transfer $500,000 of its liability on deposits to $500,000 liability on its circulating notes, without reducing its cash on hand, calling in its loans, or otherwise contributing to the usual fall squeeze in the money market. After the notes shipped by the New York bank to Minneapolis had accomplished their purpose, having circulated probably through the Red River Valley district during the fall, they would return in due and natural course to the New York bank for redemption, probably by reshipment from the Minneapolis bank for its credit, which would re-establish the deposit liability and concurrently cancel the liability on circulation. The relief that thus might be afforded to the New York banks as well as to the banks in the other central reserve cities would not be available if the banks in other districts were prohibited from paying out anything but the notes of the banks in their own district. Section 11 of Mr. Fowler's bill should therefore, in my opinion, be left out entirely.

There are other suggestions which could be made, such as further facilitating the prompt and active daily redemption of the proposed currency by making the expense of shipping the bills from one district to another for the purpose of redemption a direct charge against the general expense of the system, to be paid out of the general tax paid by the banks. This would go a long way toward facilitating and accomplishing the actual daily redemption which, in accordance with my argument, affords the currency its elasticity.

GOLD RESERVE NATIONAL BANK NOTES

ADDRESS DELIVERED BY WILLIAM B. RIDGLEY, COMPTROLLER OF THE CURRENCY, BEFORE THE GEORGIA BANKERS' ASSOCIATION AT ATLANTA, JUNE, 1903.

For more than thirty years we have had in operation, without essential or radical changes, a national system of banks with the power of issuing circulating notes. The system has well answered all expectations and accomplished the purpose for which it was designed. The notes issued have in all respects save one been most

admirable. No holder of a national-bank note has ever lost a dollar, except by its accidental loss or destruction, and they have been as free from forgeries and counterfeits as any issue of paper money can be. It was a decided advance and improvement over all previous bank-note currency to provide that national-bank notes should be printed and furnished by the Federal government, and that they should all thus be made uniform in design, quality, and workmanship and issued under the same laws and regulations. Our people have become so accustomed to these notes, uniform both in appearance and in value and so perfectly reliable, that they will refuse to consider any change which will in any way impair them in these respects.

There has, however, been one vital and serious defect in the system since its very beginning, and that is the entire lack of any elasticity in the volume of the circulation. This was predicted when the act was being considered and debated, and the prediction was fulfilled soon after the establishment of the national system. It is an unavoidable defect in any system of currency entirely secured by bonds. Such a system cannot be made elastic or in any way responsive in its volume to the factors and conditions which should determine such volume. Its changes are necessarily too slow and complicated by too many other considerations, such as the price of bonds, which may have no relation whatever to the supply of and demand for circulating notes. The advantages of basing these notes upon United States bonds at the time of the passage of the Bank Act were so great that it probably was the part of wisdom to waive the question of elasticity for the sake of the greater advantage. At present, however, with the experience of forty years to guide us, and the necessity of providing a market for bonds almost removed, it is certainly wise to try to make such changes as will introduce as much proper elasticity as is possible, if it can be done without in any way impairing the good qualities of the notes.

There are several special and very important reasons why such elasticity is very necessary to our currency system. There is no other country where there is such a great variation in the amount of currency needed for current cash transactions, owing to the vast extent of our territory, our varied interests and enormous business,

and the great value of crops and products which have to be moved at certain seasons, calling for very large and varying amounts of cash. There is no other way so good; in fact, there is no other good way to provide this needed elasticity but by means of bank notes, if they can be made quickly available when and where needed, and as quickly redeemed and retired when the work is done and the demand for them ceases.

In our system all the elasticity must be supplied by bank notes. There is and can be no periodical variation in the amount of coin and certificates in circulation which can in any way respond to variations in demand. The volume of our government legal-tender notes is absolutely fixed by statute and cannot be varied to meet changing conditions. Since all the elasticity in our supply of currency must come from the bank notes, it is therefore of vital importance that they be given this quality in the highest degree possible consistent with safety. This should be done with the greatest possible care, in order that the essential qualities of safety and uniformity in value, which our bank notes have always had in so marked a degree, shall not be lost or impaired; but if this currency can be made more elastic without danger of losing these qualities, it should be done at once.

In any plans for making this exchange it is necessary to utilize the present bond-secured currency. We should not, if we could, attempt now to change the present notes radically, or do away with them. The most conservative and practical suggestion seems to be to make no change in the present bank circulation, but to allow the banks to issue in addition to the present notes a certain percentage of notes uncovered by any bond deposit, but against which the banks should be required to hold in gold or its equivalent the same reserves as against deposits; and at the same time to add to the laws and regulations in regard to redemption as to provide very ample requirements and means for redemption and retirement. This redemption machinery can and should be made so complete and effective as to lead to constant and frequent redemption of these notes. It is also part of this plan to provide a guarantee fund for the payment of all these uncovered gold-reserve notes. Each bank will be required to pay into this fund 5 per cent. of its uncovered notes before they are issued, and this fund is to be main-

tained by a tax on this circulation. The proportion of uncovered gold-reserve notes proposed varies from 25 to 50 per cent. Fifty per cent. could be permitted with safety, but 25 is enough to supply a considerable element of elasticity, and it may be well to begin with the smaller amount.

It has been frequently shown, from figures based on the experience of forty years, that a comparatively small tax will produce a guarantee fund which will make every bank note absolutely safe in the hands of the holder. No one need ever know the name of the bank issuing a note or whether it is solvent or insolvent. He may be sure it will be redeemed for its full face value in gold or its equivalent. These figures have been published so often that it seems hardly worth while to repeat them, but there have been so many objections, based on the possibility of impairing the safety of the notes, that I give some of them again. The notes of all national banks which have failed amount to about twenty million dollars, while the banks have paid in taxes on circulation over ninety million dollars. If there had been no bond security and no assets in the banks, these taxes would have paid about four and one-half times the amount of all the notes of these insolvent banks. For the whole period from 1863 to 1901, inclusive, a tax of twenty-two hundredths of one per cent. (0.22 per cent.) on the outstanding circulation of all the banks would have paid off the notes of all the insolvent banks, if there had been no bond security and no assets in the banks which failed. If, as the present law provides, the notes were a first lien on all the assets, a tax of eight one-thousandths (0.008), or one hundred and twenty-fifth of one per cent. would have paid all the notes which could not have been paid out of the assets. The five per cent. guarantee fund, which it is proposed to provide before any uncovered notes are issued, would on this basis pay all the notes above the value of the assets of the insolvent bank for six hundred and twenty-five years, if the proportion of failures remained the same. But, it is argued, conditions may vary, and these figures are based on experience with entirely different bank notes. It is not conceivable that conditions can so change that these most extraordinary margins of safety will not be ample. The figures are so conclusive that the question of the safety of the notes in the hands of the public may be taken as established. The smallest

tax which is proposed for the guarantee fund would be very ample to secure perfect safety. This tax can be so small that any bank can afford to pay it without raising the question as to whether it is paying to guarantee the circulation of a weaker bank or not. It need make no difference whether the tax is turned into the treasury of the United States as at present, or used to guarantee the redemption of the notes of other banks.

But the argument most frequently seen in the press and heard in conversation against uncovered gold-reserve notes is that their issue will lead to a great inflation of the currency. This is a most serious objection, and, if it is true that inflation would result, the plans should at once be abandoned forever. After going through all the danger and trials of the greenback and silver craze, and having firmly established our financial system on the gold standard, it would be the height of criminal folly to introduce any change in our currency laws which would lead to a paper-currency inflation. If we consider carefully, however, the provisions under which the proposed uncovered notes are to be issued, and, above all, if we bear in mind that these notes are not to be counted as bank reserves,—that the issuing banks are to be compelled to carry an ample reserve in gold or its equivalent against them, and, further, that provision is made for such constant and frequent redemption that the notes cannot stay out any longer than they are required for current cash transactions,—we shall be forced to the conclusion that there is no danger of undue inflation. On the contrary, this change in our currency laws will introduce more factors which lead to contraction than to expansion. Both are necessary in any good currency, and, in fact, if there is any difference, contraction is more necessary than expansion, or at least should be made the easier of the two. Conditions should be such that when there is no strain there should be a gradual contraction and just enough currency be left in circulation to furnish current cash. Then when the demand increases for any reason, expansion will quickly and easily follow. The trouble with our present bank notes is that both processes are too slow and difficult, the contraction being actually limited by statute to $3,000,000 per month.

In considering these questions there are a few fundamental principles which should be clearly kept in mind. They are not new

—few, if any, good financial ideas are—novelty being one of the least desirable qualities in currency plans of laws. We are apt to lose sight of them, however, or become confused in their application.

There are two general uses for money or currency in our modern business, which are so largely based on credits and in which comparatively few transactions are carried out by the actual use of money:

The first is for use as bank reserves against deposits or circulating notes.

The second is for the daily current cash transactions and the payment of balances.

Bank notes should never be used for reserves, their true use being for current cash business only. Bank reserves should be gold, or some paper certificates which can be quickly converted into gold. As long as the greenbacks are in circulation and the United States carries a large gold reserve for their redemption, they may be considered as practically gold certificates and used for reserves. This is not a good arrangement, but as long as we have these legal-tender government notes in circulation as a part of our system, the banks should be allowed to use them for reserve. We may also have to continue to use the silver dollars and the silver certificates as bank reserves. Through the mistakes of our silver legislation, we have this silver on our hands, and the government will for many years have to bear the burden of it. Having once shouldered it and provided for it, we must make the best of it for the present. It will make the silver much better for reserves if Congress, as it should, makes it specifically redeemable in gold.

The gold coin and certificates and the clearing-house certificates for gold deposited are ideal bank reserves. As soon as it can be done, the greenbacks should be redeemed and retired, the silver also disposed of, and nothing but gold and gold certificates used as bank reserves. When this is done, we shall be solidly and firmly on a real gold standard basis, and our financial system be such that we should have to take our proper place as the leading commercial nation of the world.

Bank notes are not money at all, but mere promises to pay money, which are used for currency. They should never, under any circumstances, be counted as reserves for either national or state banks. It is surprising how often the suggestion is made to

permit this. Very recently an officer of one of the largest banks in New York told me he thought the three-million dollar limit on retirement should be repealed, and the banks authorized to count notes of other banks as reserve. He gave the usual reason that the bank notes are much better than the greenbacks, as the bank's credit adds everything to the government bond security. There could hardly be a greater mistake than ever to use bank notes as reserve. Not that they are not good and safe enough, but that such use removes all inducement for any one to send a bank note home for redemption, and puts an end to all possibility of making our currency elastic. Instead of decreasing the inducements for redemption, we should increase them in every reasonable way.

The only proper use of bank notes is for the current cash transactions necessary in the business of the community. Bank notes are the best possible form of currency for this use if made properly elastic and responsive to the demand. The composite result of having each bank supply to its own customers what currency they need, and these customers present it for redemption when it is not needed, is the best way to regulate the amount of currency which should be in circulation. It is infinitely better than any regulation by statute or by any officer of the government. Such a currency would be more efficient and more economical. It would save expensive transfers of currency from distant parts of the country. It would lessen the liability of disturbance in all our financial affairs and would be a source of strength in case of threatened or actual trouble. It would be better than an emergency circulation; it would prevent many emergencies and be a great help in meeting any which might arise. It would lessen the danger of both expansion and contraction and prevent inflation of the currency. A currency not available for reserves and protected by gold reserves and ample facilities for redemption would not be made the basis for undue inflation of credits or used for speculation. It would only be used for those legitimate enterprises which have a proper basis of credit, and only to furnish the cash as long as it was needed for cash transactions.

We cannot by legislation increase the supply of money which should properly be used for bank reserves. The addition to our currency in circulation of such an amount of uncovered gold-

reserve bank-note currency as the banks could keep out would add to the available reserves part of the reserve money now outside the banks for use in current cash transactions. But a large part of this would have to be used as reserve against the gold-reserve notes, so that it would not add such an amount to our bank reserves as to lead to undue inflation. The banks can just as well and safely be trusted to issue such gold-reserve currency as they can be trusted with deposits to be lent to their customers. They will only pay it out for value, and will, in self-protection, be more careful about lending it than they now are, because they must provide reserves and must always count upon its being sent back for redemption when no longer needed.

Owing largely to the kind of paper which we have had in circulation for forty years, the popular idea of paper currency has become perverted. The government has the power to issue and to keep in circulation a large amount of currency. This can be issued by being paid out for the government expenses. As it comes back it can be paid out again, and when revenues exceed expenses it can be deposited in banks, and thus kept in circulation. The bulk of our paper currency has been for so many years government issues thus kept in circulation, that it has come to be assumed that if any given amount of currency is authorized it will at once be issued and maintained in circulation. This, however, is not true of bank-note circulation not available as reserves, for which prompt and constant redemption is assured. A bank has no such means of putting its notes in circulation as the government. Its expenses are comparatively very small, and it can pay out notes only in exchange for value of some kind. If paid out in exchange for the note of a customer or in payment of a check against deposits, notes will stay out only as long as they are needed for cash transactions. As soon as the demand slackens, the notes will either come back to the issuing bank or be deposited in some other bank. This bank will, as soon as possible, send them for redemption, so as to convert them into something which can be counted as reserve. The notes must be easily and promptly redeemable in gold or its equivalent. This is the vital point of the whole plan, and is the most potent force with which to make the bank-note currency elastic and automatically elastic. When currency is wanted, the banks can and will

supply it. When the supply of notes exceeds the demand, they must redeem the notes and retire them until needed again. If the same reserve is required to be maintained against the gold-reserve notes as against deposits, it will make no difference to the bank whether a borrower takes the notes of the bank away with him, or leaves the proceeds of his note on deposit with the bank, except so far as the note circulation is taxed by the government. It is the very fundamental principle of bank-note circulation that there is no difference to the bank between the bank-note credit and the deposit credit. They are both obligations of the bank and exactly the same thing so far as the bank is concerned. It is only a question of the convenience of the customer, whether he leaves the credit in the shape of a deposit to be checked against or takes the notes to be used as cash. It is not so much a privilege of the bank to issue the notes as it is a privilege of the customer to do whichever suits him best.

It is important that it shall be thoroughly understood that there is no difference between the deposit credit and the bank-note credit, and that bank notes which are protected by a gold reserve, quickly and easily redeemable and not available for reserves, will not stay in circulation in greater volume than is needed for current cash transactions. With these principles fixed in our mind, there will be no justifiable fear of inflation from such notes. Any bank which can be trusted with deposits can be trusted to issue the notes. The guarantee fund will make the notes of any bank safe in the hands of every holder, no matter what happens to the bank. The main safety of the whole system, however, is the gold reserve and the constant current redemption. Constant and frequent redemption cannot be too strongly insisted upon. The notes must be perfectly free to come and go, and thus freely follow supply and demand.

The notes of the Suffolk bank system were the best paper currency we ever had in America, and they were kept good by frequent redemption, although they were purely credit notes. The system grew and was successful without government aid, because it was based on correct principles. The worst bank notes we ever had were the "wildcat" bank notes in the West, which were bond-secured. In the states where they required reserves and provided

for current redemption the bank notes were good, but where they depended on the bond security they were very bad.

The chief trouble with our present bank notes is that the supply is hardly in the slightest degree regulated by the demand. It mainly depends on the price of bonds, and the profit on circulation is so very small that the banks are compelled to figure to small fractions to see whether it pays or not. The issue of circulation, instead of being the exercise of one of the most proper and useful functions of a bank, in supplying currency as needed by the people, becomes rather a speculation in bonds, and there are thus introduced into the regulation of the volume of the currency factors which have no proper relation to it whatever.

The Secretary of the Treasury has recently very wisely and properly encouraged the increase of circulation, in anticipation of the demand which may be hard to supply next autumn. The outstanding notes are now for the first time over four hundred million dollars. No one can tell whether this is enough or too much, or how much more it may be by September or October next. How much better it would be if we had a system which would automatically adjust this amount, each bank supplying its own customers according to their needs. There is far more danger of inflation because these bond-secured notes become redundant, than there would be if the banks could issue a portion of their circulation in uncovered gold-reserve notes, with such proper redemption requirements that they would retire themselves when no longer needed, and could be kept out only by exertions on the part of the bank, and then only as long as they were demanded by the public for current cash transactions.

Objection is frequently heard to having a great number of small banks, widely scattered, issue uncovered notes. On thorough consideration this objection does not seem to be serious, and there are some counterbalancing advantages. The notes being furnished by the government, there is no danger of fraudulent over-issue. The proposed proportion of uncovered notes to the capital of the bank is not large, and the regulations could be made such as to remove the temptation to organize the banks for the note issue only. The constant redemption spoken of so often would check this. Those of you who remember the time when you had notes out which you

were constantly looking to have presented for redemption doubtless realize that such notes are a source of considerable anxiety and solicitude. These small banks are now allowed to take unlimited deposits. On account of the guarantee fund the notes will be safer than the deposits. If the banks are fit to take unlimited deposits, they are fit to issue a limited quantity of notes, protected by a gold reserve. One chief advantage of the issue by the number of banks is that the gauge of the quantity needed by widely scattered banks, each in close touch with its own customers and community, would be the best possible way to determine the proper amount required. They would feel and supply the demand more quickly and collect and retire the notes more promptly, quietly, and with less disturbance, when these were no longer needed in circulation.

It is not claimed by the most enthusiastic advocates of this change in our currency, that it will cure all our financial ills. We cannot by any means yet known prevent speculation and overtrading. It seems to be a fixed law in all human affairs, and especially in business, that events run in cycles, and that we are bound to have periods of too great activity, followed by corresponding periods of depression. Modern business is the result of the development of credit, and must be done largely on credit to be done at all. There never is a time when there is money enough to liquidate all outstanding credits, or even any large part of them. We are thus always exposed to the possibility that some unexpected and unavoidable event will lead to such a demand for liquidation that many who have debts cannot meet them, and this will lead to a panic or crisis, followed by a period of depression in all lines of business and trade. It is idle to expect to cure or change this by legislation, but we may by proper financial and currency laws remove some of the causes of disturbance and diminish the chances of sudden demands for liquidation. We are confronted with a situation in business to-day, one of the dangers of which is the fear of a demand for currency next autumn which may check business of all kinds. Being forewarned and expecting it, every one is now making every possible preparation for it, and in this there is much reason for hope that serious trouble may be avoided. It may be said that this situation is not due to our currency laws, but to entirely different causes. This may be, and doubtless is, largely true. But our

currency and banking system is a great factor in the situation, and if we had a better and more elastic bank currency, it would be a source of strength now when needed. If our banks had been in the habit of supplying the varying demands for currency, and an automatic elastic system were in operation which all knew would take care of the demand as it came, there would have been no necessity that extra endeavors be made by the United States Treasury to increase the circulation; and there would also be less danger of inflation from such a circulation as could then be issued and expanded than from our present bond-secured circulation, which, after it has been expanded, can only be contracted at the rate of $3,000,000 per month. This is a matter of far greater importance to the people who want and need this money than it is to the banks. A man who wants currency for his business and cannot get it is much worse off than the banker who cannot furnish it. It may only mean a loss of profit to the bank when it means ruin to the customer.

The people who want this currency for handling their crops and products are entitled to the credit based on the wealth of marketable articles they have produced. They are entitled to it in the shape which is most convenient to them, whether as a bank deposit subject to check, or current cash. It is the duty of the government to supply them with the best facilities which can be devised, and to enact such laws as will enable the banks to serve their customers to the best possible advantage to the whole country. This question is a matter of equal, if not greater, importance to the entire business community, who find every year their calculations interfered with, if not overthrown, by the annual disturbance which is due to the demand for currency to move the crops. That we allow this to go on year after year without any attempt to cure or stop it, is an absolute disgrace to us.

SOUND VERSUS SOFT MONEY

ADDRESS DELIVERED BY ANDREW JAY FRAME, PRESIDENT OF THE WAUKESHA NATIONAL BANK, WAUKESHA, WIS., BEFORE THE WISCONSIN BANKERS' ASSOCIATION, AT MILWAUKEE, AUGUST, 1903.

I GRIEVE to disagree with some of my good friends, yet I yield to no man in patriotism. I desire ameliorated conditions. When we sum up the years of agitation for asset currency and a sound solution of the elastic problem, and find that the only product that has been seriously considered to date is the Fowler bill—to the fallacies of which I make specific reference hereafter—I conclude it is easier to criticise than provide a remedy for incurable diseases. The disease under discussion might be diagnosed as "hard up." A large majority of the human family have an annual attack of it, and many have it in chronic form. Issuing I. O. U.'s will rarely cure the malady, but liberal libations of conservatism wonderfully ameliorate severe attacks.

The battle of the standards which have been fought in the United States for more than a quarter of a century, culminated successfully March 14, 1900, in the adoption of the world's standard, gold. Since then, instead of strengthening our foundations by unequivocal laws, making our vast quantity of inferior silver coin—which is ever decreasing in intrinsic value—redeemable in gold; instead of wiping out our greenbacks, thus removing another burden from the government which is not tolerated by any progressive nation, the burden of song has been to undermine our present foundation by the injection of an additional quantity of inferior currency called asset currency, under conditions not paralleled in any progressive country, and which, as certain as the laws of gravitation, will drive our gold abroad under the Gresham Law, or produce still further inflation in prices, resulting in riotous speculative ventures, and consequent deeper depression when the ebb tide in our prosperity sets in. Such a result is as inevitable as that history repeats itself. The Kaffir proverb, that "he who will not profit by the experience of the past, gets knowledge when trouble overtakes him," has no terrors for the speculator. Under the impetus of rapid fortune acquired by some, in the swelling tide of prosperity, the get-rich-quick fever has intoxicated the many. Some men ordinarily conservative have wavered in their course

and been drawn into the maelstrom of underwriting speculative combinations in the hope of excessive profits. The promoters have not been able to sell enough of their watered stock to the innocents to pay loans, so banks might meet the call of the country for cash to move the crops; and under this plea, together with the unsolved sound solution of the elastic problem, the common complaint of all ages for "more money" is heard abroad in the land, when over-speculation is primarily the cause of trouble. In fact, crops could not move faster, as transportation facilities are taxed to their utmost every fall. This is rather a grave charge, but let us diagnose the case and draw conclusions as to its merits.

Britain, after a campaign as long and bitter as ours over the Gresham Law, and the expulsion of her gold by the injection of too many bank-notes into her circulation, unequivocally adopted the gold standard in 1816. The integrity of that standard as against the uncertainties of other national standards has been maintained with a fidelity that commands the confidence of the world to the extent that London has long been the world's clearing-house. Will New York soon win that center if we inject an additional quantity of inferior currency into our circulation?

Christ said that a wise man builded his house upon a rock, but the foolish man upon the sand. When the rain descended, and the floods came, and the winds blew, the wise man's house fell not, but as to the foolish man's house great was the fall thereof. Is not this a perfect simile to apply to the building-up of the superstructure of our great credit system upon a sound metallic currency for a foundation as against the sands of a credit currency? The pages of history are strewn with proofs that when the great instrument of exchange is deranged, all trade, all industry, is stricken as with a palsy. That instrument of exchange recognized by the world as the solid foundation that does not totter when the storm rages in its severest intensity, is the only foundation for a prosperous people to rest upon; and to-day our coffers hold over a billion dollars of it. This is a billion-dollar country, and we need it. This gold has come to us since 1873 in the natural course of trade, in response to the well-known principles of the Gresham Law and monetary science, as expounded by Adam Smith, Ricardo, Jevons, Sumner, and many other eminent economists, and as also clearly set

forth in what Professor Sumner dubs the most important document in financial literature, "the celebrated bullion report of 1810 to the House of Commons." I have quoted these maxims before, but deep-seated error requires repetition of them again and again. Summed up, these principles are:

1. That rich countries will have all the coin they need, providing no impolitic act of legislation interferes to force it out of circulation by the injection of *inferior currencies.*

2. When the coin in any country exceeds the effectual demand, no vigilance of government can prevent its exportation.

3. It is the province of government to settle the *quality* question of money, and the needs of commerce will settle the *quantity.*

In proof of the above maxims, history says, Chinese walls, jails, shotguns, or hanging did not prevent exportation of coin, and in these modern days the object-lesson of the exportation of more than twenty-five millions of gold in the past three months, in the face of the plea of the asset currency advocates for "more money in the United States," is more potent than pages of logic.

Let us fix the "quality" question and stop tinkering with the "quantity," as the needs of commerce will settle that.

From the latest reports of approximate stocks of money in the world, I will quote a few:

IN MILLIONS

	Population	Gold	Silver	Uncovered Paper	Total	Total per Capita Circulation
United States	80	$1,250	$670	$580	$2,500	$30.00
Great Britain	42	528	117	117	762	18.29
France	39	903	420	134	1,457	37.38
Germany	57	763	207	153	1,123	19.92
Russia	130	715	103	...	828	6.25
Canada	5½	20	5	say 50	75	13.63

In 1873 the United States had $18 per capita circulation, or a total of $750,000,000, and practically all in promises to pay, California and vicinity refusing to adopt soft money. To-day, after our battle for sound money, according to the above table, we have about $30 per capita, or $1,250,000,000 of gold and practically the same amount of inferior money, our vast hoard of silver being nearly two-thirds fiat. If an additional quantity is needed, let gold

flow in under natural economic laws, the same as the $1,250,000,000 have already done, $62,000,000 in 1902 being added to our stock. Let us not inject inferior asset currency on top of our present excessive soft-money stock and drive gold out, thus undermining our household.

The unprecedented production of gold for the past few years has paved the way for supplying all the gold this "rich country" needs to fill the channels of trade. The increase to nearly $400,000,000 in gold certificates in the past three years, to save abrasion and perfectly serve our wants in every way, is in line with the trend of all Europe as expressed by Professor Edmund Théry in *L'Economiste Européen* in 1898. He said that the gold in European banks increased in fourteen years—1883 to 1897—from $700,000,000 to $1,700,000,000, and that "in all sound-money countries the *bank-note* is in course of becoming a simple *gold certificate* redeemable on demand."

I assert without fear of intelligent contradiction, that the new Fowler bill for asset currency to be issued by thousands of banks, large and small, has no parallel in any progressive country; that it it a discarded, unsuccessful experiment of the past; that it is unsound, and gives preferences to picayune creditors as against the larger creditors, the millions of depositors, thus producing distrust; and distrust breeds panic. It also lowers our standard. Let us particularize a little.

Canada has thirty-five large banks with about $70,000,000 of capital (which has grown very little in twenty-five years) and about $40,000,000 of surplus. They have many branches. They issue currency based on a 5 per cent. deposit and a first lien on assets. The right to issue notes is limited to banks with *not less than $500,000* subscribed capital. Banks pay out only their own notes, sending others home for redemption. What is the result? Canada has 3,500,000 square miles of territory, or about that of the United States including Alaska, and much of it very productive; her population is a measly 5,500,000; her total banking power is not equal to that of little Massachusetts with only 8,315 square miles of territory; neither is it equal to that of Illinois, Pennsylvania, or New York.

We hear the cry for "more money" in the United States. By

the foregoing table we have $30 per head—one-half gold. Canada averaged in 1902 about $13.63 per head, and of that only $3.64 per head is gold. Would inferior asset currency furnish our live country with its vast foreign trade an ample quantity of international money or drive out gold under the Gresham Law? If the banking system of Canada has anything to do with her lack of progress, then let us stand by our system under which our progress seems to know no bounds. Comparison with unprogressive Canada is simply ridiculous.

The Bank of England issues £18,175,000 of notes on a deposit of the same amount of government securities. It has 30 to 40 million pounds sterling in notes outstanding constantly in addition, but every note has its value in gold behind it. The large banks of England, Scotland, and Ireland in 1844 and 1845 were limited to the amount of their then outstanding uncovered notes, and 70 per cent. of the right of issue of any of these banks going out of business since that date has reverted to the Bank of England. Since 1844 this has reduced the maximum uncovered issues £6,000,000 and added £4,175,000 to the Bank of England issues. Of late the whole amount of asset currency issued by all the big issuing banks of England, Scotland, and Ireland has been approximately the insignificant sum of £5,000,000 sterling, or about two-thirds of the maximum allowed, and all the rest of their circulation has government securities or gold behind it. What is the secret? Inability to pay out any notes but their own, and *unlimited liability* of every bank stockholder for every note in circulation. How much circulation would our banks issue if under such restrictions, including an *"unlimited liability"* clause on issues? *The clear intent of Britain is entirely to eliminate bank-note currency from her circulation, excepting only that of the Bank of England.* Mr. Fowler, at New Orleans and before a committee in Congress, stated that Scotland could issue $148,000,000 asset currency. When? In 1845 the uncovered circulation maximum allowed by law was £3,087,209, and in 1898 it was £2,676,350—according to the Monetary Commission report—(see p. 281)—and *Sound Currency Red Book* (p. 187).

Since 1848 the Bank of France has had the sole right of issue in France. Mr. Fowler, in his zeal for asset currency, states that

the Bank of France can issue $1,000,000,000 of notes, but he fails to state that the Bank of France of late years has had approximately $700,000,000 of circulating notes outstanding, and has kept about 90 per cent. of its outstanding notes in coin in its vaults. If the small deposit account of say $150,000,000 is added to the circulation, the average coin reserve has been about 75 per cent. of the whole. (Let us not forget that the coin reserve of national banks is but 8 per cent. of such liabilities.) That great reserve of coin naturally inspires confidence. The balance of its liabilities even is partially covered by loans to the government, so that the bank could pay over 75 per cent. of all its liabilities by selling its government paper without calling a dollar of its loans. The Bank of France is more a bank of issue than a bank of deposit, as its issues have averaged five times its deposits for many years.

The Imperial or Reichsbank of Germany is allowed a maximum issue of uncovered notes to the amount of about $120,000,000. Five per cent. interest is charged on issues in excess of this for emergencies. For ten years past it has had a metallic reserve of say 80 per cent. on an average circulation of about $300,000,000. Add deposits to circulation and the reserve of both has been about 60 per cent. The many other issuing banks are now reduced to only five large banks that are allowed to issue asset circulation to the extent of the comparatively insignificant sum of $18,000,000, any excess being covered by treasury notes (which notes are fully covered by gold in the government war-chest), notes of other banks, or coin. L. Carroll Root says: "The National (or Imperial) Bank is the center of the system, with the evident intent on the part of the government ultimately to transfer to it the *sole right of issue.* Now note: *The issue of the uncovered notes allowed a few years ago in order to nurse along the speculative adventurers resulted disastrously, and Germany has been in a depressed financial condition ever since.* If only the 5 per cent. emergency currency had been issued, the speculative fever would probably have been checked before serious trouble ensued.

The following countries have only one bank of issue:

	Capital	Reserves Required on Note Issues
The Bank of Austria......	$45,000,000	40% coin and 60% quick assets
Bank of Belgium..........	10,000,000	33½% coin on notes and deposits
Bank of Netherlands.......	6,333,000	33½% coin on notes and deposits
Bank of Norway..........	3,333,000	50% as to notes in coin
National Bank of Denmark	7,250,000	37½% as to notes in coin and 150% assets besides
Imperial Bank of Russia...	20,000,000	Over 100%

There are three large banks in Italy and three in Greece.

Sweden has a large state bank, and some private banks that issue currency based on a deposit of mortgages, etc., in public custody.

It is not clear from the foregoing that the *great centralized institutions* of European nations are assuming the issuing functions of the currency, with a *metallic foundation,* as heretofore referred to in Professor Théry's article?

What about former New England Banking, the Suffolk system, the Banks of Indiana and Louisiana, and several others so often quoted by asset-currency advocates? Simply this: On pages 302 of the report of the Monetary Commission, under the head of "New England Bank Currency," we find that "in some states an *unlimited liability* for both notes and deposits was enforced upon the officers in case of mismanagement. In some instances the stockholders were liable to the amount of their stock for the ultimate payment of the notes, and in Rhode Island they were subject to *unlimited liability.*"

Under the "Suffolk System" each country bank kept $2,000 on deposit in Boston without interest. Banks were compelled to pay out *only their own notes,* and send all others to Boston for redemption. This compulsory redemption, lack of confidence in paper money generally, and scarcity of gold in those days brought about the redemption of bank-notes in that system ten times over every year, thus entailing exasperating annoyances, constant assorting, and expense for express, etc.; and history says: "Country banks were loud in denunciation of the system, and there was always friction between the city and country banks." With all the rigid regulations the loss to holders of notes in failed banks in that small system was $877,327. As no man has ever lost a dollar in the past forty years, nor sleep either, under our vast national system, distrust is entirely eliminated; therefore no one troubles himself about redemption.

In the *Sound Currency Red Book,* in an article by Horace White, a strong advocate of asset currency, we find (pp. 207-10), under the head of "State Bank of Indiana":

> On all applications for loans above $500, a majority vote of five-sevenths of the board was necessary, and this must be entered on the minutes with the names of the directors so voting. Directors were individually liable for losses resulting from infraction of the law, unless they had voted against the same and caused their votes to be entered on the minutes, and had *notified the governor of the state* of such infraction forthwith, and had *published their dissent in the nearest newspaper.* Any absent director to be deemed to have concurred in the action of the board, unless he should make his dissent known in like manner within six months.

One-half of the stock belonged to the state. The bank's principal business was loaning its own notes, its deposits being but a small fraction of its capital.

We also find under the head of "Louisiana Bank Act of 1842":

> 1. A specie reserve equal to one-third of all its (the bank's) liabilities to the public.
>
> 2. The other two-thirds of its liabilities to be represented by commercial paper having not more than ninety days to run.
>
> 3. No bank to pay out any notes but its own.
>
> 4. All commercial paper to *be paid at maturity,* and if not paid, or if an extension were asked for, *the account of the party to be closed and his name sent to the other banks as a delinquent.*

It would take a powerful glass to spy out a gallery of bankers that would stand such ridiculous rules as those.

References warmly advocating the Indiana and Louisiana systems by Horace White and Congressman Fowler were made at New Orleans before the American Bankers' Convention.

In all seriousness: If we were to adopt the Louisiana Act of 1842 of compelling the keeping on hand of 33⅓ per cent. in specie of all liabilities to the public, the national banks would hold to-day—

More than................................	$1,600,000,000 specie
Whereas, they hold say 8 per cent. or about	400,000,000 "

The rigid Louisiana Act would require an additional $1,200,000,000 of coin reserve. Under the Louisiana, Indiana, Iowa, and Ohio experiences, which are almost parallel as to reserves, we should be compelled to keep three to four times as much specie reserve as we do now. Where would the coin come from, and who would retain their national bank charter under such rigid rules and many others not enumerated? Progress would simply be throttled.

Again, under the Indiana experience, the banks were limited in their aggregate loans to two and one-half times their capital. The aggregate of loans, including other securities in national banks to-day, is over five and one-half times their capital.

Although distrust, insufficient coin, and general wildcat banking drove home for redemption the asset currency issued in these isolated cases, no loss occurred because of over rigid regulations, excessive reserves, and limitations of development. Those were days of the ox-team and not paralleled by twentieth-century conditions.

To obtain any elasticity whatever, at least one of three conditions is necessary: (1) Distrust in the mind of the holder of a note, thus hastening redemption; (2) a compulsory law to drive it home; (3) a graded tax sufficiently high to make it unprofitable except under stress.

The first head needs no argument. Greenbacks are not elastic, although redeemable in gold, because the element of *distrust* is wanting. The second head, by paying out only their own notes, operates in Canada in sending all currency home twelve times a year, and in Scotland all notes are redeemed twenty times over in a year. Under like conditions in the United States, with our thousands of banks and vast extent of territory, if the quantity of such currency as suggested by Mr. Fowler was issued, the cost in labor, time in transit both ways, expressage, etc., would entail an expense to the banks of millions of dollars annually, besides being practically impossible.

The new "asset currency" Fowler bill contains these sections:

SEC. 10. That, for the purposes of this act, New York, Chicago, and San Francisco shall be redemption cities, and all of the national banks redeeming their notes at any one of these cities shall constitute a redemption district, and the New York redemption district shall be known as number one, the Chicago redemption district as number two, and the San Francisco redemption district as number three.

SEC. 11. That if any national bank shall receive such circulating notes of any other national bank located outside of its own district, it shall not pay them out over its own counter, but shall forward them *either* to some bank in the district to which the notes belong, *or* to some bank located in the redemption city of its own district, and then they shall be returned to the bank issuing them, *or* to some bank in the district to which the bank issuing them belongs.[1]

[1] See House Bill No. 16228, 2nd session 57th Congress

Now note: What a lovely occupation the tellers will have assorting out notes of banks "outside of its own district," especially if they are like present issues—packing them and expressing to "some bank in the district to which the notes belong" *or* "to the redemption city of its own district," and then they shall be returned (by express again) to the issuing bank, *or*—I will add to the *nearest* and *cheapest* spot where they can be got rid of, then vice versa to reimburse banks for cash reserves. Would not this process, with its localized currency, petty and expensive annoyances, *pettifogging at redemption,* fail in its object—to wit, direct compulsory redemption? Would it not be clearly an act of credit currency inflation? A stretched rubber with the elasticity gone?

The element of distrust doubtless would be small, because of the guarantee fund and first lien on assets, but that same element in times of financial trouble would be deep-seated with the great army of depositors, because of that first lien. The depositor has just as much right to know he has equal rights in assets as that a banker will rest more sweetly if he knows his borrowing customer has given no *first lien* to another on his assets.

If we prefer the noteholder by a first lien to the depositor who takes the dregs, this will surely be the result. Under the present law, for every $100,000 of circulation issued $100,000 of government bonds are deposited to secure it. These bonds cannot be spouted for any other purpose, and in case of a bank failure the $100,000 circulation is fully cared for and the premium on the bonds is left for the depositor, together with all other assets. Under the asset-currency scheme, in case of failure of a bank, the $100,000, which ought to be in government bonds to care for circulation, is loaned on commercial paper. The 1902 report of the comptroller of the Currency (pp. 386, 387) shows for banks that have failed in the past forty years this result:

Nominal assets at date of suspension..............	$149,554,311
Collected from assets..............................	77,529,651
Leaving losses of..........................	$72,024,760

or about 48 per cent. of assets. Is it not clear that for every $100,000 in commercial loans instead of in bonds the depositors would receive $48,000 less in dividends than under the bond-secured plan?

The third point is the only one that ought to be considered seriously. Under ordinary conditions, the fluctuation in the interest rate should be the barometer which ought to check undue expansion and inspire conservatism. Under fear of occasional extraordinary disturbed conditions, if cash could be provided on sound principles to loan to all solvent parties, serious losses would doubtless be prevented; but such cash should at once by a heavy tax be forced to return to its reservoir as soon as its work was accomplished, so that no act of inflation would result. Its operation should be like a water reservoir, always ready to put out an incipient fire and at once refill again. In the panic of 1873 about $33,000,000 of clearing-house certificates were issued, and in 1893 but $66,000,000. Last fall the New York Clearing House Bank reserves were short $23,000,000. Mr. Gage stated that that shortage compelled $92,-000,000 in liquidation of loans and deposits, the reserve being one-quarter of the deposits. If $23,000,000 to $66,000,000 will put out a severe fire, why do we need $175,000,000, as provided by the Fowler bill, as the entering wedge, and more than $500,000,000 later as the intoxication grows under the stimulus of soft money, as indicated by Mr. Fowler in his address at St. Paul on July 7, last? Let us not forget, though, that under the Fowler bill *forced redemption* is a farce; therefore the reservoir will likely be empty when the fire grows warm. The proposition to issue asset currency to the extent of 100 per cent. of national bank capital I consider positively dangerous.

Right here permit a suggestion. It may not be a perfect plan in accomplishing the end sought, but no proposition yet offered is perfect:

1. A bill somewhat on the lines of the Aldrich measure ought to be put upon the statute-books to prevent locking up unnecessary funds in the United States Treasury.

2. Legalize clearing houses as banks of issue on the same form as national-bank currency, secured by clearing-house certificates issued on the same plan as heretofore, to any bank in the clearing house to which the clearing-house committee sees fit to grant it. Five per cent. interest to be charged from date of issue to date of deposit by the borrowing bank, of funds with the United

States Treasurer to redeem its borrowings, when the clearing-house certificates will be canceled and securities returned.

This will permit not only national, but state, private, or any other clearing-house bank, to get advances in times of financial stress. Country banks can get advances through their correspondents, thus serving all the banks of the country. The conservatism of the clearing-house committee will prevent unnecessary issues, the rate of interest will prevent inflation, and redemption will automatically take place as soon as pressure for funds is over.

It is a significant fact that the Chicago Clearing House has never issued any clearing-house certificates. An examination of records shows materially larger reserves of cash on hand and due from banks, as against New York reserves for many years past, thus clearly revealing the cause. If New York will avoid trouble, let her keep adequate reserves, reduce her paying interest rate on balances when money is easy, curb the stock jobbers' demands, and when country banks call for their own deposits to move crops, small troubles will result. As Old World metropolitan cities are internal, New York must look to her laurels, or Chicago, located practically in the center of the garden of America, will capture the prize.

I challenge any man to prove that since 1893 there have been more than two fall seasons when the money market has been above a normal or reasonable level, and then speculation and not crop movements were the primary causes of trouble. I will specify these causes later. The slight raise in rates was generally appreciated after the very low rates for most of the year.

Do we need more fiat money in the United States? Look at the table of approximate stocks of money, as noted heretofore:

	Silver Coin	Uncovered Paper
United States	$670,000,000	$580,000,000
Great Britain	117,000,000	117,000,000
France	420,000,000	134,000,000
Germany	207,000,000	153,000,000
Russia	103,000,000	None
Canada	5,000,000	50,000,000

Nearly all silver is subsidiary except that of France and the United States. Does anyone think, from the foregoing immense issues aggregating $1,250,000,000, which exceeds the combined stocks

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of silver and uncovered paper in Great Britain, France, and Germany, that we need more soft money injected into our circulation? Never in the history of our country was our credit system so expanded as it is to-day. We do not need additional I. O. U. or *asset currency,* which only adds fuel to the fire of speculative frenzy. What we need, if anything, is less inferior money and more gold for a foundation that will stand through storm as well as sunshine. Under natural economic laws, over $550,000,000 of gold has come to us in the past five or six years. More will not undermine, but strengthen the foundation. It will come to us, if we need it, only by keeping out cheaper money, and especially credit currency which is not as good as what we now have. We have ample assets with which to buy more gold in the world's markets, if the natural needs of commerce demand it, and we need only some provision for extraordinary emergencies, as noted under the third clause. In the emergency of the Barings' failure in Great Britain in 1890, the Bank of England borrowed from the Bank of France £3,000,000 and from other outside sources £2,000,000 more. If we keep our credit unstained and unstrained, the world will lend to us in need, as we have plenty of collateral.

A late writer in a New York magazine advocated asset currency in the United States to lower and hold steady interest rates, in order that New York might wrest from London the title of the world's financial center. What logic! Great Britain has the most rigid and least elastic of all currency systems in the world, but she has a metallic foundation that the world never questions. Her surplus capital is invested the world over and is subject to her beck at all times. These are clearly the reasons why rates of interest are more steady, and her prestige would doubtless wane under credit currency expansion such as we are now discussing.

Our friend Mr. Fowler also advocates asset currency to lower the rate of interest in the United States. Rates of interest with us now are about one-half those of thirty to forty years ago, and every decade sees a decline in rates. After carefully reading the best authorities on political economy, I conclude that the cause is accumulated surplus capital, and not running the printing-press increasing outstanding I. O. U.'s. Mr. Fowler also says that present rates of interest for the benefit of five million borrowers ought to be

cut in two, but how about the benefits to the fifteen million depositors, the eighteen million holders of insurance policies, and millions of other savings of the people generally? The greatest good to the greatest number clearly does not require ruinously low rates of interest. I challenge any man to show me a country where a very low interest rate prevails that can compare with ours in general prosperity.

Then what is the primary cause of trouble? My answer is, over-speculation. Let me quote and see what the consensus of opinion is:

The *Chicago Economist* of November 15, 1902, says, in speaking of the New York Chamber of Commerce action on "currency reform":

The present impulse in New York comes from the recent stringency in the money market, the decline in stocks, and the inability of the promoters to bring out a large number of new issues that are proving rather burdensome to them. After all, what New York really needs is an act to reform human nature. No amount of legislation respecting the currency will prevent the human animal from going too far when he gets into a speculation. That is what is the matter just now at the financial center of the United States.

From *American Banker* of October 11, 1902, I quote:

"It is believed," says the London correspondent of the *New York Evening Post*, who is well informed "that the effect of the New York market's over-speculation and diversion of capital into huge combines is still to be felt. European banks are clearly not willing to spare gold for New York, and the reason apparently is that they think such shipments would serve merely to fan speculation on the stock exchange. This positon appears to have been distinctly taken by the president of the Imperial Bank of Germany, who declares, in substance, that American financial interests are paying the penalty of *undue rashness* in *speculative activity*."

The *New York Financier* of October 13, 1902, says:

Financial institutions have been more than liberal in their support of the rising markets, but they recognize the fact that an end must come sometime to all upward movements, and the consensus of opinion inclines to the belief that now is the time to put on the brakes. The firm foundations already laid will support legitimate expansion, but they are not able to carry the *top-heavy superstructure which Wall Street has been attempting to build of late.*

Bankers admit that present reserves are too low. They feel that their plain duty from now on is to increase them. The country has adopted a dangerous gait in the last year, and the wisdom that is leading bankers to refuse longer to be a party to it is to be commended. On their conservatism rests the continuation of real prosperity.

The *Journal of Commerce, Commercial and Financial Chronicle,*

and the *Bankers' Magazine* of New York have articles in a similar strain.

In the *New York Evening Post* of November last, in the American Bankers' Convention, New Orleans, special issue, I find:

The simple truth of the matter, recognized by every observer with his eyes open and his wits at work, is that our promoters and speculators have pushed their undertaking beyond the limit where available capital was sufficient to bear the burden. When such a situation is faced by any community, the inevitable outcome is liquidation of liabilities. This is the process now at work upon the markets, and *it is the only corrective of the situation.* The course of events, regarded from the unbiased view of the economic critic, has been as logical as any in the history of finance. The syndicates resorted indirectly to the American banks, to provide the capital and hold the securities until the public's mood should change. The last stage witnessed was the expansion of the promoters' demands beyond even the available resources of the domestic banks and the resort to European lenders on an unprecedented scale to discount our promoting banker's notes. When the foreign capital began, as it did two months ago, to be recalled, the result was not in doubt.

From the *Chicago Banker* for December 18, 1902, in a well-written article by "a retired Chicago banker," I quote the following:

There is a certain irony of fate in the fact that we are debating this question eight-and-fifty years after the settlement which stands for the enlightened judgment of England's financiers. The directors of the Bank of England had the unlimited right to issue notes against their portfolio, until Peel's Act of 1844 gave the Old Lady of Threadneedle Street the straight-jacket she has worn ever since. As Bagehot says in his classic work, entitled *Lombard Street,* this authority was, in more than one instance, used with the extremest unwisdom, so that devastating panics followed hard upon the heels of the reckless speculation which *too great facilities for borrowing had engendered.*

W. R. Lawson, writing to the *London Bankers' Magazine,* said:

Whoever else may be to blame, the New York banks did not owe their recent trouble to undue zeal on behalf of the trade of the country. It was not their commercial discounts that reduced their cash reserves below the legal minimum. A specially bad feature of the situation was that so much bank money had been diverted from commercial to stock financing.

In another article he says:

Fears of there not being money enough to go around always appeal to the mercantile imagination, and American bankers have for a good many years persistently harped on this chord. They have not been discouraged by the paradox that the United States has one of the most copious currencies enjoyed by any country of equal commercial rank.

He laughs at our follies and declares the "combineers" are the

source of trouble. Metropolitan journals everywhere make similar comments. Does not this compilation of opinions, made more than six months ago, seem, in the light of later events, prophetic?

It seems needless to quote further than to say that the notable address of Frank A. Vanderlip, in October last, at Wilmington, N. C., ought to ring the death-knell of any methods to bring about further inflation, with its resultant high prices, increased imports, decreased exports, thus bringing about much sooner a reaction in our progress, which is as certain as that history repeats itself. If anyone seeking truth will see the hand-writing on the wall, he is commended to read carefully the standard authorities on political economy for parallel conditions, and the fogs of the common error as to the cause of trouble would be illumined by a clearer light. In view of all these facts, is our trouble lack of money, or is it over-speculation?

Doubtless some are clamoring for asset currency because they think there is profit in it; but as surely as there is material profit in its issue, and it is not confined to great centralized institutions which are more likely to be prudent in issuing it, there being no monopoly in banking, the multiplication of banks would soon destroy such profits. I assert that a national bank has no more right to issue currency when its credit is strained, and force it on an unwilling public without interest or penalty, than have state banks, or a merchant or manufacturer, under like conditions. It never should be done except in emergencies. In any case, collateral should be put up as security, and a tax imposed high enough to drive it out of use as soon as its work is done. The interest rate is the check-valve to prevent undue expansion and insure conservatism, not only in banking, but in all commercial pursuits. I assert with confidence that no case is extant to-day that compares with our subject under discussion. Large centralized institutions only have the right anywhere of issuing a limited amount of asset currency. Germany is financially depressed to-day because of the abuse of the license accorded her great centralized bank, as heretofore noted, Canada which is harped about so much, is one of the most unprogressive countries.

The early ox-team days, when bullocks, wampum, beads, skins, etc., were legal tender; when collateral and gold were scarce, have

given way to abundance of gold, plenty of collateral, abundant prosperity, and a confidence that has built a colossal superstructure of credit unknown in ancient or modern times. Shall we build a metallic foundation on which this structure shall stand, broad, strong, and enduring; or shall we undermine the house we have built by piling credit on credit and misname it "reform"? O Reform! Reform! What crimes are committed in thy name! Blow up the balloon to the limit, and then give it another pull; give the rubber another stretch after it has been drawn almost to the point of breaking; take another drink when the intoxicated patient is over-loaded. No! No! Let us pour oil on the troubled waters, put the brakes on the over-worked engine, put more ballast in the hold, instead of adding to the sails.

This country is to be congratulated that in the year 1902 no asset currency was allowed, thus causing a check to the wild and reckless pace of the promoters, assisted by some over-greedy bankers. Another safety-valve was the wonderful prosperity of the country as a whole, even if we did not have asset currency. If banks could have issued asset currency, thus still further inflating conditions under the get-rich-quick fever, I fear results would have been somewhat like Germany's 1900 experience. Foreign banks realized our condition and put the brakes on by raising the rates on money so high that further expansion was checked. The interest rate should be the corrective for all troubles, except occasional emergencies which might call for more heroic treatment. The world is open to us to borrow in case of need, and with quick transportation and plenty of good collateral, with slight fluctuations in interest rates, legitimate interests will rarely suffer. An occasional panic is inevitable in all progressive countries. It has its day, like the measles and the grip. Political economists of all ages have wrestled with the knotty elastic problem in the hope of evading panics, but have failed. In these latter days the woods are full of popular elastic nostrums to cure a case of short cash to move the crops, when the true diagnosis proves that the common principles of prudence have been violated, and over-speculation and excessive promotions have run riot. The shock of last fall has probably sobered up the more conservative; therefore, as the unex-

pected usually happens, the forewarning will probably prevent a repetition of the trouble.

It is to be hoped that the bargain counter which has been laden with rich pickings for conservative buyers with cash, in the past few months, has been nearly cleared; that the undigestible securities will be dumped into the sewer, and progress along conservative lines once more be resumed with Anglo-Saxon energy.

A weighty responsibility rests upon our American Bankers' Commission, and more with our statesmen, if this question of asset, elastic, or emergency currency is to be settled on sound and enduring lines. Our patriotism ought to rise higher than to settle this momentous question with a view to larger profits for the banks. If New York is to become the world's financial center, the quicksands of asset currency, added to our present oversupply of soft money, will retard the day, on account of loss of confidence in our standard, and only a gold foundation of international money will hasten it. If this country is to continue its wonderful onward progress, it will not advance on exploded academic theories or Populistic nostrums, but on sound and conservative lines. I firmly believe, from a careful survey of the world's history on banking, that asset currency, as a cure-all for economic troubles, is a fraud, a delusion, and a snare. The remedy is worse than the disease.

QUERY

In these days of great accumulation of surplus capital, as indicated by low interest rates, expanded credit generally, and large per capita circulation, permit this pertinent query:

If a bank extends its loans to the limit of its assets, then swaps its I. O. U.'s without interest—secured by a first lien on its assets, the depositor taking a second mortgage—for its customer's note at 5 to 6 per cent. thus carrying out the asset currency advocate's ideas, does not that act smell loudly of "kiting"?

Confidence upbuilds, distrust paralyzes,

PROPOSED CHANGES IN OUR BANKING LAWS

ADDRESS DELIVERED BY CHARLES G. DAWES, EX-COMPTROLLER OF THE CURRENCY, AND PRESIDENT OF THE CENTRAL TRUST COMPANY OF ILLINOIS, CHICAGO, BEFORE THE PENNSYLVANIA BANKERS' ASSOCIATION, AT PITTSBURG, SEPTEMBER, 1903.

THE subject which I propose to discuss under this caption is that of asset currency and branch banking, and it is one which has agitated the bankers of the United States for the last eight years. This question first began to be discussed about the time of the Banking Association meeting at Baltimore—the time when the Baltimore plans, so called, were first enunciated—and you will remember that at that time these so-called plans for asset currency were offered as means primarily of governmental currency reform. The panic of 1893 had exposed the inherent weakness of our governmental financial system as it was at that time. That inherent weakness had existed years before that, but it took a period of deficient governmental revenues to develop that weakness and create public sentiment in the United States for its reform. A favorable general public sentiment is always necessary in this country of ours before enacting long-discussed legislation affecting our interests.

The panic of 1893 had developed a deficiency in governmental revenue. The expenses of the government were greater than the income of the government. As a consequence, the gold reserve in the Treasury of the United States, upon the existence of which depends the interchangeability of the greenbacks and other forms of governmental credit currency into gold upon demand, was encroached upon for the purpose of paying the expenses of the government—governmental income not being sufficient—and there came to be a disproportion between the gold in the treasury and the demand currency liabilities of the government. That disproportion commenced to undermine the confidence of the people in the stability of our medium of exchange, and as a measure of governmental currency reform one of two things had to be done: either that disproportion had to be lessened by decreasing the amount of currency liabilities—in other words, by retiring the greenbacks; or it had to be lessened by increasing the amount of gold in the treasury, allowing the currency liabilities to remain as they were. Now, those who were in favor of asset bank-notes were in favor of retiring $346,-

000,000 of greenbacks of the government which were in circulation, and, for the purpose of filling the vacuum in the general circulation to be thus caused by the retirement of the greenbacks, they urged the provision for these notes. The government, however, did not take that means of currency reform. Under the law of March 14, 1900, the gold in the treasury was "stored up" and properly protected against periods of deficient governmental revenues. Confidence was restored in the stability of our governmental credit currency, which depends for its value just as much upon its exchangeability into gold at the Treasury upon demand, as a check against any deposit depends for its value upon its exchangeability into money, or into another form of credit equally as good as money, at your bank. Therefore there does not at this time exist any excuse, so far as a governmental necessity is concerned, for these asset notes, which at that time were advocated as chiefly important because with their aid we could cancel the greenbacks and shift the burden of gold redemption of a portion of the credit circulation of the country upon the shoulders of the banks. We have, however, since the passage of the law of 1900, heard this argument for asset notes, and some reasons for it exist now as then, and are most important. But they are based upon the needs of the business community as distinguished from the governmental needs.

It is proposed under these plans—I think we are all familiar with them—to relieve the banks of the United States from the necessity of depositing government bonds as a condition precedent to the issuing of bank-notes, and to allow them to issue these notes against their assets; the notes to be secured by a redemption fund of 5 per cent., as under our present system, and that redemption fund to be kept replenished by a limited tax upon the issues of such national banks as choose to issue the notes. Then, in the case of the failure of any particular bank which has issued these notes, there is to be a first lien upon the assets of the failing bank for the benefit of the noteholders of the bank, as distinguished from the deposit creditors of the bank. And it has been estimated that, if the national banks of the United States had, since the establishment of the system, issued the notes which are in circulation now, and had not had any government bonds upon deposit with the Treasury of the United

States as security, the tax necessary to be levied to have redeemed all notes in full would have been a very small one.

Now, in considering this argument, I want to call your attention to one or two things, lest we be misled by these figures. In the first place, this system of note issues, which it is proposed to authorize by law, is an optional system of bank-note issue. It is not necessary, under this proposed law, for a national bank to issue these asset notes unless it desires to issue them. That being the case, it is very difficult for us to make an estimate of the amount of tax upon these issues which will be necessary to make the notes safe, based upon the experience of the national banking system; for we do not know how many of the 5,000 national banks in the country will choose to issue these notes. If only a few hundred of the weaker banks should choose to issue the notes, the tax should not and would not be estimated the same as if one thousand strong banks chose to issue the notes. If a thousand banks chose to issue the notes, the tax should not be the same as if four thousand banks issued the notes. But we do not know how many national banks will avail themselves of this privilege of issuing uncovered currency, and yet that tax, levied for the purpose of making these notes safe, is a limited one—a tax which thus limits the liability of each one of the issuing banks for the notes of another bank.

Again, we do not know what the national system will be if the banks of the United States are given the privilege of issuing uncovered currency. Mr. C. C. Hay, of the *American Banker*, told me that the record collected by this magazine showed that at this time there were 17,635 banks in the United States, of which about 5,000 were national banks, and over 12,000 banks were outside the national system. The bulk of those outside the national system are small banks, and the greater part of them eligible through conversion to come into the national system. Now, if they should come into the national banking system for the purpose of availing themselves of the privilege of issuing uncovered currency, how do we know what the national banking system will be?

Why, with this chance of difference in the condition of the banking system to which the proposed law applies, should this tax be thus limited? Simply because the framers of this bill know that,

unless that tax is limited, the stronger banks will not issue the currency. The stronger banks of the United States are not going to undertake to guarantee and be responsible for the issues of the weaker banks. But what moral right have we, by limiting the tax, to put a risk upon the community, whose bank-notes are now safe, which the banks themselves are not willing to take for the purpose of securing the profits incident to the issue of these notes? I am very well prepared to admit that, provided there is a first lien in favor of the note-holding creditors as against the deposit-holding creditors of a bank, a limited tax is sufficient to make the notes safe; but my contention is that a first lien in the case of uncovered notes, as distinguished from the present bond-protected bank-notes of the country, is unfair and unjust to the deposit-holding creditors of the country; and, in addition to that, if, under this proposed system, this first lien is allowed, the business of the country will be greatly injured by the lack of confidence which such a system will tend to create in the minds of the deposit-holding classes as a whole.

Right here—for I want to emphasize the importance of this argument against a first lien for noteholders—let me speak of what the chief function of a bank is. The chief function of a bank in any community of this country is not the note-issuing function. The note-issuing function in the most of the great continental banks is the chief function of the bank, or of very much more importance, at least, than the note-issuing function of the banks in this country. The great function of the banks in this country is the production of purchasing power. A depositor leaves $1,000 with the bank and receives credit for it. At the same time, under the rules of banking, the bank can loan $750 of this $1,000 in the shape of credit upon its books to another customer, thus increasing the purchasing power of the community by 75 per cent. of the original deposit. And so, in this country, under the normal and ordinary operations of the banking system, there has been built up in the banks a magnificent deposit credit to the people of the United States. There is now on deposit in solvent banks of the United States over nine billions of dollars, the bulk of which is subject to check; and yet the entire outstanding circulation of gold and silver and paper of the United States government is only about $2,250,000,000, or about 25 per cent. of that sum. Now, it is through checks and drafts drawn

against that magnificent deposit balance that 90 per cent. of the business of the United States is done, and it is not at this time a matter of so much importance as to whether this comparatively unimportant function of issuing notes is changed. The important thing to consider is what we are going to do in connection with any change in the form of this comparatively unimportant function of issuing notes to endanger the confidence of the people in the safety of this magnificent deposit credit. For when you commence to endanger the confidence of the people in that deposit balance, when you frighten, in any degree, the deposit-holders, then is the time that we are face to face with all the trouble incident to panics—with all the trouble incident to contraction. That is the great question in the discussion of these plans for asset notes. Do not endanger this prosperity which we have built up at so much cost in this country to-day, by doing anything which tends to lessen the confidence of the public in the great credit balances upon deposit in the banks of the United States.

Now, let us see how the first lien—coming back to that—may do it. It is undoubtedly true that, if all the losses which would have accrued in the past to holders of national-bank notes, if there had been no United States bonds as security for them, were apportioned over the entire amount of deposits in the country, the percentage of loss would have been a very small one. But losses upon these notes would not be apportioned over all deposits. This first lien localizes losses. It means that in any community, should a bank fail, the loss of the deposit-holding creditors, through that issuance of asset notes, would not be the proportion that the loss in that particular bank would bear to the total losses under the entire system. It means that all the loss upon the notes of that particular bank must come out of that particular set of depositors. Now, there would be a very great difference in the effect of those localized losses upon the confidence of the people in the safety of deposit balances, and the effect if that loss could be fairly apportioned and distributed. And under any of those plans, if we take as far as we safely can the experience of the national banking system as a guide, it will, I think, be seen that by giving a first lien for the benefit of asset-note holders as distinguished from deposit-holders, the percentage of their claims which deposit-holders in an insolvent bank will then receive will be

very greatly decreased—decreased, in my judgment, to such an extent that, after a series of these failures have occurred, especially in times of a panic, the public will come to appreciate the possibility of the severe losses which this first lien will inflict on them. Thus, by authorizing the issue of these uncovered notes with a first-lien provision, we shall lessen the amount of the deposit balances of the United States, and by lessening the confidence of the public of the United States in the banks as the proper custodians for their funds, we shall inflict the greatest damage upon our commerce and industry and prosperity.

Now, a first lien is inherently a moral wrong. There is no inherent moral right about it. The money of the deposit-holding creditors of a bank has gone into the assets of the bank side by side with the money of the note-holding creditors, and when that bank fails we have no inherent moral right to say to the deposit-holding creditor: "Your dollar shall not be paid until and unless the dollar of the noteholder is paid in full." As I say, there is no inherent moral right about it. The contention is that a public necessity exists for a different kind of bank circulation from that in use at present; that in that public necessity for a different kind of circulation can be found justification for the moral wrong of a first lien. But my contention is that there is no such public necessity at this time in the United States as will justify that wrong. It is no argument to say that a noteholder possibly lives at a distance from the bank, and for that reason he has not the chance to determine the standing of the bank that the deposit-holder has, who does his business in closer contact with the bank. That is no ground which can be claimed as a justification for the great injustice to be done in the proposed distribution of the assets of an insolvent bank. As a matter of fact, the trustworthiness of banks is not a matter, from the very nature of things, with which depositors can easily acquaint themselves; not even the stockholders in a bank know very much about the bills receivable of their particular bank. A bank, to be successful, cannot publish its own business and the business of its customers to the world. The question of trustworthiness is left by the depositor to the bank examiners as representatives of the government, and cannot be determined by a patron of a bank as a rule—there are exceptions, but not as a rule; and this is not a reason which

justifies this radically and fundamentally different treatment in the two classes of creditors, to say that the noteholder is at a distance and therefore must be protected in preference to the depositor who is nearer. As a matter of fact, a deposit creditor of necessity must often trust banks at a distance.

And this first lien, which is worshiped as a sort of fetish by currency orators—this first lien provision is an exception in the currency systems of the world. If one listens to the speeches of these so-called reformers at this time, he would imagine that a first lien is something vitally necessary. There are only two countries in which the first lien exists, so far as I understand. It does not exist in France, England, or Germany. It exists in Canada—an unqualified first lien—and in Canada, in the future, is to be seen the first test in times of business adversity of the value of uncovered asset currency subject only to a nominal tax. In this country we have a qualified first lien, and what qualifies the first lien is the fact that an unshrinkable asset has to be deposited with the treasury of the United States before the notes can be issued. In other words, the proceeds of those notes are invested in unshrinkable assets; so as a matter of experience, it has been demonstrated that the lien has not worked to the injustice of the deposit-holding creditors. But how would it have been under our system if that qualification, if that condition, had not existed? Under the present system of note issues, the proceeds of the notes are invested in an unshrinkable asset, to wit, United States government bonds. Under the proposed system the notes will be invested in commercial assets, upon which, in the case of an insolvent bank, there is, of course, a shrinkage. Under the asset plans, not only must the depositor sustain a percentage of loss upon which his own money has been invested, but an additional loss of the same percentage upon the assets in which the noteholders' money is invested. Experience has demonstrated that there is practically no shrinkage in government bonds, and that therefore, as a matter of fact, under the present system, the first-lien feature has not operated to the loss of the depositor as it would under the asset system. As I have said before, the first lien is bound to localize the losses on currency, and that localization of severe losses is one of the most dangerous features of this first-lien provision. I maintain that a first lien, unless the deposit-holding creditor is pro-

tected first by a requirement that an unshrinkable asset as security for bank-notes be deposited with an impartial trustee to protect him against losses made through bad investments of the notes, is a feature which would cause lack of confidence in the banks of this country, and cause a decrease in the deposit balances, and thus tend to bring about financial straits; for, as I have said before, the confidence of the people of the United States in the banks of the country is a most important thing to consider, and much more important than a change in our form of bank currency at this time.

I have made my speech thus far from the standpoint of an opponent of the present plans for reforms in our bank currency which are offered to the people. I believe in reform in bank currency, but I do not believe that these particular plans offered to us at this time are safe. We can, however, both secure reform and at the same time be safe. I admit that we need additional elasticity in our currency, but I believe that elasticity must not be obtained at the expense of the solidity and safety of the medium of exchange, in which the business of this country is done. We need elasticity a great deal more in times of a panic than in the fall when the crops are to be moved. A panic in this or in any other country comes about so often, and we cannot avoid it. It comes through the ordinary and simple results of ordinary and simple business. In any country where the credit system is in effect as here, panics will come. A man makes a purchase of a piece of property for $5,000. We will say he sells it for $10,000, and takes $5,000 in cash and a note for the other $5,000. The price of real estate rising, that man sells it for $15,000, and takes $5,000 cash, and $5,000 in a note payable in one year, and another note of $5,000 payable in two years; and so on, increasing in proportion to cash. Not only in the real-estate business, but in all business, the credits of a country grow out of proportion to the cash in which those credits are redeemable, and sometimes hastened by speculation; but whether hastened or not, the time is sure to come when credits get out of proper proportion to the cash in existence in which credits are redeemable. By and by there exists a great disproportion between the credits of a country and the cash in which they are redeemable. Some bright man sees it, and calls for payment of his note; another sees it and calls in his note; a number of men see it, and call for their notes, and a

general feeling of unrest and disquietude is developed; and suddenly you have frightened the greatest creditor class we have ever known, the depositors in the 17,000 banks of the country, and they become alarmed and call for their credit—the credit due them in the shape of deposit balances from the banks; and suddenly we are face to face with all the disasters and all the troubles which are incident to what we call a financial panic.

We have a panic about every twenty years in this country. There was the panic of 1817-18; the panic of 1837; the panic of 1857; the panic of 1875, hastened out of its time, perhaps, by the inflation incident to the Civil War; there was the panic of 1893; there is the panic which is off in the future. We cannot stop financial panics; but if it were possible for us to evolve a plan for some sort of an emergency currency which would help the banks of the United States to tide over that period of tremendous demand for cancellation of deposit balances, we should have taken a great step forward in this matter of currency reform, and, in my judgment, the only practical step at this time toward the solution of these problems. The period of acute monetary demand is not long. The very height and climax of the panic of 1893 was reached in May, when it was impossible on certain days to borrow money upon government bonds, I am told, in New York City. Yet in October, 1893, six months after that period of acute demand, there was the largest collection of idle and unloanable funds in the banks of the United States which there had ever been since the foundation of our monetary system. The demand for more money at that time is short, not long. From the effects of a panic, of course, the country is years in recovering. It was five or six years after the panic of 1873 before stagnated industries commenced to revive. It was in 1898, five years after the panic of 1893, before this present period of great prosperity could be considered as fully started. But the acute demand for money—and a panic always arises out of a demand for sudden cancellation of debt—is for a period of but a short time. Now, can we find some method of issuing in time of panic additional bank credit in the shape of uncovered currency, because all asset currency is a form of banking credits, and a provision for asset notes at this time—mistake it not—is an argument in favor of allowing additional use of bank credits? An asset note is a form of banking

credit, and it is a form of which the people will use only so much. Can we devise some method which at the time of a panic will allow the issuing of a small amount of additional bank credit without endangering the confidence of depositors in their deposits, and without the necessity of an unjust and wrong and demoralizing first lien in favor of uncovered asset-note holders? Any asset notes are a form of bank credit, and there is a limit to the amount of credit with which a business community can be saturated; and just in proportion as you saturate, in normal times, like the present, a community with bank credits in the shape of asset notes subject only to a small tax, you will lessen the ability of the banks to issue these notes in times of a panic.

Let us illustrate this point from this much-talked-of system in Canada. They have this asset-note system. To be sure, they cannot have any 4,500 or 5,000 banks to which to apply it. They have some thirty-eight centralized banks with branches to apply it to. There is a fundamental and radical difference between the two systems. Let us see in what condition they now find themselves with their asset currency. On March 30 the deposits in the Canadian banks amounted to about $418,000,000. Their banking capital amounted to about $73,000,000. The note issues at that time were about $58,000,000; their cash resources about $80,000,000—I have not figured it exactly—or about 18 per cent. of their deposits and note liability. They are allowed under the law to take out these asset notes up to the extent of the capital of the banks. In other words, they have been authorized to put all the notes they can into circulation up to the extent of their capital, and they have been able thus far to get out $58,000,000. The time for the supreme test, the crisis for Canada, the time for the true test of her asset currency system, is yet ahead of her and not behind her. When the panic comes it will be seen whether the elasticity of her currency system is sufficient to carry her through. The deposits of Canada are constantly increasing, and the uncovered note circulation of Canada is constantly increasing. Notes are kept afloat by the banks for the sake of the profit there is in it in these normal times. The elasticity of their currency is more like wet leather, which stretches principally one way, than like rubber, which contracts and expands. Now, what help will Canada get during the next panic from this asset

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circulation? Since her banks have already issued about $58,000,000 out of an authorized issue of $73,000,000 bank notes, they can take out only an additional $15,000,000 in notes. That is less than 5 per cent. of the combined deposit and note liabilities of the banks. Surely these asset notes will be more of a menace than a help to the Canadian banks in the next panic.

If Canada, with its lesser business, and with its greater facilities for the redemption of asset notes, can keep in circulation $58,000,000, or about 80 per cent. of their capital—can keep that amount afloat in the shape of asset notes—how much easier would it be for 5,000 national banks in the United States to keep 25 per cent. of their capital in asset notes afloat! We shall not have an elastic currency under the Fowler bill to the extent of 25 per cent. of the capital of the banks of the United States, for these notes could be kept afloat in normal times for the purpose of profit, and it is nonsense to talk of them, if issued under nominal taxation, as being of any material assistance in times of a panic. You would, under the Fowler bill, be increasing the credits of the country at a time when we do not want increased credits. This is the time, above all others, to take in sail, not to put it out; and if we are influenced by arguments about the necessity for more bank currency, we must be very sure that the new bank-notes are so guarded and so protected that they do not add to the danger which now confronts us, of too much extended credit, of too much speculation. In other words, we do not want at this particular time more credit money. We do not want an asset currency which will go out into business and be a foundation of still more business credits as well as being a credit in itself. We want some sort of a currency which can come out in panics, which can be used at such times to carry us through; and not a currency which will help us into a panic while we are out of one. The crying need of the day is some sort of a currency which can be used, not as an instrument of speculation and profit at the present time, but which will help tide us over in time of financial need. The bankers are just as anxious as all other good citizens for any change in the currency system which will tend to make it more safe, and they stand, in my judgment, for only those reforms which will be good for the community as a whole; and this question of profit incident to a small expansion in the credit facilities of the

banks is one that nobody considers of special importance except in its economic effect upon the country as a whole. It is a time when we should provide for trouble ahead, not lay the foundation for it. Therefore let us favor a small issue of asset notes subject to a high restrictive tax of 4 or 5 per cent.—a tax high enough to provide for their redemption without the necessity of a first lien, and high enough to prevent their use as an instrument of current profit in normal times, thus preserving them for use in times of panics and financial emergency. This is the most practical step for us to take at this time.

I hear it said that we conservatives are becoming educated, by degrees, to the ideas of some of those who have been preaching to us so long and so radically on the subject of branch banking and asset currency. In my judgment, the education is in the other direction. If you compare the McCleary bill, Secretary Gage's first bill, and other bills gotten out by some other gentlemen a few years ago, with the plan for asset currency as it exists at present, you will see a marked progression on the part of the so-called currency reformers to the standard which has been the standard upheld by the conservatives for several years, and not a progression of the conservatives toward the more radical ideas of the so-called currency reformers. If we could have an emergency circulation, subject to a high tax, to be used in times of a panic, and not to be used as an instrument of currency, profit, or speculation, we should advance in the right direction. This currency would come out for the general good, as well as for the good of the banks, and help tide over panic periods. It is no new plan, and there is nothing original about it. We have the experience of the world to guide us. They already have a system of repressive bank currency tax in Germany. This tax, of necessity, must be so high as to provide without question for the redemption of the notes for the short time they are in circulation, without necessitating an unjust prior lien of the noteholder over the deposit-holder, and, when the need should be at an end, will force them into retirement again. And for that reform, it seems to me, we can safely stand. It is unwise to talk of joining the branch-banking question in the discussion of asset notes.

We have a great country, with diversified conditions and cus-

toms. We want at this time something to go into law to help us, and we know there is no chance at this time of a branch-banking law. Let us stand behind some one simple step. Let us combine and stand behind some simple step in advance. We do not have to-day any single man with the influence in financial discussion that Hamilton had in his day. The great men of to-day have not to such an extent the centralized confidence of the people of the United States. This is such a large country now. In Hamilton's time the country was new, everything was new, all departments were being founded then, and great men could, comparatively unhampered and unhindered, force into law their fundamental systems. To-day we have so many men in the country who are financiers, there are so many different views and such a diversity of interests among our people, that to get together on some rallying-ground upon which all can combine for the passage of legislation is a necessary thing and a difficult thing.

I want to say one word more in connection with branch banking. The little country of Canada is held up to us as a model, notwithstanding the fact that you could take twenty banking systems like Canada's, put them side by side, and they would not equal the strength or power of the banking system of the United States. The resources of all the banks of Canada are not equal to the resources of the banks of the one great city of New York in the United States. Then, why model a system of 5,000 national banks, scattered all over this great country, after a small banking system like that in Canada, and which has its real test ahead of it? We have here the greatest banking system in the world. I have heard it held up to great criticism. I have heard Americans visiting in Europe say they were ashamed of our banking system, or the banking system of the United States, in comparison with that of Europe. We have not built up the banking system of the United States upon the continental idea. Two lines of thought have run along side by side in financial matters in the United States. The old banks of the United States—the First and the Second Banks of the United States—were the American expression of the idea of continental banking, but we did not follow along that line. Possibly we made a mistake. I do not think so. We did not follow along in those lines, but built up a banking system upon another theory. The banking system in the

United States was built up by protecting the rights and the opportunities of the small man and the small bank in business—built up from units, individuals, from the bottom up! The European system of centralized banks with branches was built from the top down. It has been of the greatest importance to this nation industrially that we have pursued the American idea in banking. It is the same idea that underlies the theory of protective tariff. Let the little man grow. Let him have a chance. Give the American a chance, and he soon grows in size and strength, so that in time commercially and financially he will come to dominate the world. And he has in one sense done it in this banking system of ours, which at times is held up for ridicule and criticised severely in comparison with the systems of Europe. This system of ours, this banking power of ours, in 1890 was a little more than the banking power of the United Kingdom, and a little less than the banking power of continental France. Within ten years this banking power of ours has grown so that it is now within 12 per cent., not only of the banking power of the United Kingdom, but of the banking power of the United Kingdom and of continental Europe put together. And we have built this system up by protecting the small banker.

Now, however we may differ as to this question of branch banking, let me say right here that, as practical men, we all know that at this particular time there is no chance of a branch-banking law going upon our statute-books. Right or wrong, debatable question as it may be, there is at this time in the United States a widespread apprehension lest this great process of centralization and consolidation of industry and of capital is not too greatly curtailing the opportunities and chances of the individual. Right or wrong, debatable as that question may be, we know that that apprehension exists. And we all know how futile it is to expect to have passed into law any change which removes existing restrictive provisions of law against branch-banking systems, and opens still further the way for the same process of consolidation and centralization to go on in the banking business as is now going on in general commercial and industrial business.

I do not want to be considered an obstructionist. I think it is time to take a step in advance, but take a step that is safe. We do not want to consider the question of branch banking as a matter

even for discussion among the bankers of the United States, as a thing at present practicable or possible. I do not think, as a matter of principle, we can afford in this country to depart from our present theory of banking. Under it has been developed the greatest banking system of the world. The time is not ripe for branch banking in this country, if such a time ever will come. We do not have to disagree entirely with the economists in holding this position. We know that the rates of interest on certain forms of collateral loans will be lower under a branch-banking system. We know that the farmer having grain, or any other commodity which has a cash value in the established markets, can through branch banking get a lower rate of interest. There will be fewer rooms to rent. There will be fewer clerks to employ. There will be certain economies in the management of the business, which might in the older and more fully developed communities in the East fully compensate the people for the loss of some of the advantages the small bank gives to the community and the public. But it is doubtful. Branch banking would certainly not aid in building up our undeveloped country, and the newer sections of the United States. He who would stand for the common good of all should argue the question from the standpoint of the people of the undeveloped country, and from the standpoint of the people building up a great and undeveloped country; for the United States as a whole is still undeveloped. If you discourage the small bank, you do not injure so much the depositors of a small community, but you curtail the opportunity for credit of the small borrower; and it is the small borrower of the United States who has built up the country. It is folly to maintain that an agent of a branch bank, acting at a distance under delegated authority, can exercise the same discretion and have the same latitude in the making of loans in which the personal equation is an element, as does the local bank acquainted with local conditions and authorized to cope with a local situation. It is the man who goes in to start a little business—a little wholesale business, a small manufacturing business, a small mining business, or some other business of small beginnings—who has developed and built up this country. He does not often have collateral. The money he borrows often forms a certain, and even large, proportion of the total investment made by him—money advanced him because he has character and stand-

ing with the local bank. The local banker knows him, has followed him, trusted him, and gives him credit upon his representations that he will pay, not upon his collateral. Out of the little shops of the Deerings and the McCormicks and of the Studebakers of years ago, and the little businesses of such men, have grown these magnificent corporations which are commencing to dominate the world; and it is by the protection of the opportunity of the small man to credit that we are building up this great commonwealth of ours. The man who will bring out from this soil its riches, the man who will be a great manufacturer, the great farmers of the future, some of them are hard up now, some are having trouble right now to pay back the little money advanced them with which to start their struggling industries by the small banker who trusted them. Some of them will go under, but more of them will keep on, until this great state of yours, like this great nation of ours, shall dominate over its competitors through the rule of the "survival of the fittest," and the protection of the rights of the individual by law.

BANK NOTE EXPERIENCE OF TWENTY YEARS—1882-1902

AN ADDRESS DELIVERED BY HORACE WHITE, FORMERLY EDITOR OF THE NEW YORK EVENING POST, BEFORE THE BANKERS' CLUB OF CHICAGO, IN THE FALL OF 1903.

THE national banking act passed in 1864 provided that the whole amount of national bank notes should not exceed $300,000,000 and that such notes should be secured by bonds of the United States at the rate of not less than $100 for each $90 of notes. The banks were required to hold the same percentage of cash reserve against notes as against deposits. The whole amount of $300,000,000 was taken out during the following six years. In 1870 new banks could not obtain circulation except by buying it from others. A premium as high as 6 per cent. was paid for it in some cases. No bonds could be received as security for circulation, bearing interest at a less rate than 5 per cent. Most of them bore interest at 6 per cent. A tax of 1 per cent. per annum was imposed on the average amount of notes in circulation.

In 1865 Congress passed a law making the note-issuing function of banks proportionate to their paid-up capital. Those whose capital did not exceed $500,000 might issue 90 per cent. of such capital. As the capital increased, the proportion of notes diminished. Banks having $3,000,000 or more of capital could issue notes to the amount of 60 per cent. only.

In 1870 Congress extended the aggregate limit of bank-note circulation to $354,000,000. In 1874 it repealed the requirement of a cash reserve to be held against outstanding circulation, and adopted in lieu thereof a 5 per cent. redemption fund to be kept in the treasury at Washington. In 1875 the sum of $342,000,000 of circulation had been taken out. This was the net amount; that is, the amount outstanding, less the part which was in course of retirement by banks in liquidation, etc. In the statistics which follow, where I speak of the volume of note circulation, I shall mean the net amount.

Congress then repealed the aggregate limit altogether, but did not change the proportions of circulation to capital allowed to individual banks. Although the limit of volume no longer existed, and although new banks were coming into existence all the time, the circulation now began to decline, falling to $302,000,000 in 1877. The reason for this decline is found in the refunding of the national debt. As the time was approaching when the 5-20 bonds would be redeemable at par, many banks embraced the opportunity to retire their circulation, sell their bonds, and save the premium which still remained. Probably all of them did so, but most of them bought bonds of the new issue, bearing lower rates of interest. A certain proportion of them, however, either discontinued circulation, or reduced their allotments, or postponed taking out the amounts to which they were entitled.

In 1878 the circulation began to rise again, reaching $332,000,000 in 1882. The population of the United States by the census of 1880 was slightly over 50,000,000.

A decline of the bank-note circulation now began and continued for nine years. It reached its minimum ($125,000,000) in 1891. During that interval there was a contraction of $207,000,000 of the bank-note circulation, or more than 62 per cent. The reasons for this decline were: (1) the rapid redemption of United States

bonds, more than one thousand millions of which were paid off during that period; and (2) the augmentation of the price of the remainder. The 4 per cents rose to nearly 129 in the year 1889. The population of the United States by the census of 1890 was 62,000,000—an increase of 12,000,000 in ten years.

The next five years embraced the panic of 1893. In this period the treasury was required to issue new bonds to the amount of $262,000,000. The price of 4 per cents running thirty years fell as low as 104.49, at which rate the bond syndicate of 1895 took $62,000,000, the rate of interest on the investment being 3¾ per cent. This rate of interest offered greater inducement to banks to take out circulation, which rose to $190,000,000 in 1898. In that year the Spanish war began and Congress issued $200,000,000 of bonds bearing interest at 3 per cent. These bonds afforded a more profitable basis for bank circulation than the previous issues. The circulation, however, did not increase much until Congress passed the law of 1900 authorizing the issue of notes to the par value of the bonds and to the full amount of the capital stock. The same act authorized the exchange of existing bonds maturing in 1904, 1907, and 1908 for 2 per cent. bonds to run thirty years. These bonds were made receivable at par as security for circulating notes. The tax on notes so secured was reduced to one-half of 1 per cent. per annum, the tax on other notes remaining at 1 per cent.

These provisions of the law gave a new impulse to the bank circulation, which rose to $328,000,000 in the year 1902. It was less by $4,000,000, however, than that of 1882, although population had increased from 50,000,000 to 76,000,000 during the interval, and wealth had increased in a still greater ratio. The percentage of circulation to national bank capital in 1882 was 81.60; in 1902 it was 53.32. The ratio of bank notes to population in 1882 was $6.50 per capita. In 1902 it was $4.25 per capita.

During the last twelve months the Secretary of the Treasury, by offering to the banks premiums in various forms, has managed to increase the note circulation $55,672,680, bringing the whole up to $379,515,824 on the 30th of September last. To secure this increase he has made use of $161,778,285 of the treasury surplus as bank deposits, the use of which has probably been worth to the depositories as much as 3 per cent. during the past year. In other

words, a bonus of at least $5,000,000 has been given to the banks for taking out $55,000,000 of new circulation. During this time government bonds to the amount of $265,295,960, maturing in 1904, 1907, and 1908, have been and are still drawing interest at 5, 4, and 3 per cent. respectively. I allude to these facts not for the purpose of criticising the Secretary's actions, but merely to show that this increase of bank-note circulation is highly artificial and cannot last. The circulation even now is only 50 per cent of the amount issuable under the law.

These are the main facts constituting our bank-note experience of twenty years. What next? The country is gaining rapidly in population and wealth. Both of these elements call for additional circulating medium. The growth of population calls for an arithmetical increase: but the growth of wealth at the same time calls for a geometrical increase, since the same number of persons carry more money in their pockets when they are flush than when they are pinched. But we have come to an end of currency expansion under existing laws, I think.

It is true that gold certificates can be obtained to any amount in denominations not smaller than $20, and it is a fact that the volume of such certificates, which was $363,311,089 in September, 1902, has increased during the past twelve months to the sum of $420,487,869. While the Secretary of the Treasury was lifting the bank-note circulation $55,000,000 by jack-screws, the gold certificates increased $57,000,000 by a natural process. It would seem, therefore, that gold certificates, though costing one hundred cents for every dollar, are not the most expensive form of circulating medium that our government offers to the trading community. The volume of gold certificates now exceeds the net amount of bank notes by more than $40,000,000.

Our circulating medium at the present time consists approximately of the following items:

Gold	$1,000,000,000
Silver (including subsidiary)	625,000,000
Legal tender notes	363,500,000
National bank notes (net)	379,000,000
	$2,367,500,000

From what quarter may we expect any increase of circulating

medium commensurate with our increasing population and wealth? I assume that nobody expects a new issue of greenbacks, or the free coinage of silver, or any coinage of that metal except for subsidiary purposes. We already have as much gold as we need to ensure stability in our monetary system. Forcing ourselves to buy more of it than is needed to safeguard the bank exchanges, is a waste of capital.

Twenty years ago I foresaw the crisis that we have now reached. In an article published in Lalor's "Cyclopedia of Political Science" in 1883, I said:

"The conclusion is irresistible that when the national bonds are paid off, or when they become so scarce that the banks cannot obtain them, or so high in price that no profit can be made by issuing notes upon them, the national bank-note system must come to an end, unless the capital of the banks themselves and the responsibility of the shareholders can be relied upon as sufficient security. It is plain that if a bank has in its own vaults the capital heretofore invested in the United States bonds which it has deposited in the treasury, its ability to redeem its notes will be perfect. The question is how to ensure that it shall always have this capital within reach."

I then made certain suggestions for what we now call "asset currency," but I did not include in them the safety fund plan, or mutual insurance of bank notes, that was first tried in New York seventy years ago and is now in successful operation in Canada.

Ten years later, while the World's Fair was in progress, the American Bankers' Association met in Chicago and I was asked to deliver an address to its members. I took for my text "An Elastic Currency," and showed that a bond-secured currency never could be elastic, since its movements were governed by the price of bonds and not by the demands of trade. The silver craze was then at its height, and the country was vociferous with the demands of politicians and the so-called debtor class for more money. I thought that it was a fitting time to show how a sound currency could be obtained in exactly the amounts needed by legitimate business, more expeditiously and cheaply than by buying silver bullion. With the view of offsetting the silver craze, as well as of meeting an impending crisis in the bank-note system, I renewed

my previous suggestions and added a sketch of the old safety fund system of New York, showing how it might be easily adapted to our present exigency. Other speakers at this meeting advocated the same plan, and it acquired so much headway that in the following year (1894), when the association met at Baltimore, it adopted a plan for asset currency outlined by the Baltimore clearing house and presented by one of its members. This action, however, was taken rather for the purpose of bringing the subject sharply before the banking mind of the country than with the expectation of early action by Congress.

Nearly ten years more have now elapsed. The silver craze has passed away, but asset currency remains a more burning question than ever before. The present Secretary of the Treasury, Mr Shaw, is one of its advocates. His predecessor, Mr. Gage, is another. The House Committee on Banking and Currency in the last Congress adopted a bill to carry it into effect, but was prevented by the state of public business from bringing it to a vote. I do not consider it a misfortune that a vote was not then reached. It is not desirable that any important change should be made in our banking laws until a majority of bankers are themselves in favor of it. Any change in our system of note issues must have regard to two prime considerations; first, the goodness of the notes; second, the machinery of issue and redemption. After the goodness of the notes has been guaranteed all else is matter of detail, which bankers alone are competent to devise or pass judgment upon.

As the doctrinaire and ex-editor, I am now disposed to stand aside and leave the subject wholly to the banking fraternity. They cannot avoid the task, however much they might like to, for this is one of the unsettled questions that have no pity for the repose of nations. I am glad to know that some bankers in Chicago comprehend the situation and are considering the details of a plan of asset currency, in order first to satisfy their own minds, and then to enable them to answer questions which may be asked by others. I shall not enter upon any discussion of details, but there are some general principles upon which I would like to say a few words.

And first as to "emergency circulation." This is a phrase applied by certain speakers and writers to any issue of bank notes over and above the amount which the speaker or writer considers

sufficient. When that maximum is reached the theory of the emergency man is that any overplus of notes issued should be subjected to a tax sufficiently high to cause their speedy withdrawal from circulation. Naturally there is a very wide range of opinion as to what should constitute an emergency. The most common measuring rod is the bank's capital, and the usual dividing line between tax and no tax is at 50 per cent. of the capital; anything above that to be subjected to a tax ranging from 1 to 6 per cent. and increasing as the percentage increases. There are serious objections to this scheme of taxation. In the first place, it tends to defeat the very object of an emergency circulation. That object is to relieve stringency and check panics, by enabling banks to issue their credit speedily in a form that everybody will gladly accept. But the tax, if onerous, will prevent the banks from issuing their notes and giving the relief sought for. The avowed purpose of the tax is to send the notes home to the issuing banks as soon as possible. But it will not have that effect because when the notes pass into circulation they pass out of the banker's control. He cannot call them in. The only thing he can do to stop the tax will be to deposit legal tender money in the treasury to offset them. But this will reduce his cash reserve and curtail his power to discount commercial paper. Every dollar thus taken from his reserve will curtail his discounts by four dollars or more, and thus the emergency circulation, if issued, will cause more stringency than it will cure. But I do not think that it would be issued under these conditions.

The advocates of this policy point to the example of Germany, where a tax of 5 per cent. is imposed on note issues of the Reichsbank in excess of a certain amount. But there are important differences between the two systems. The Reichsbank, by means of its three or four hundred branches, can get possession of its surplus of notes at any time. They come in as daily deposits and can be retired whenever the bank finds it advisable to do so. Moreover, the dividing line between tax and no tax in Germany is found in the bank's cash reserve, not in its capital. It is allowed to issue 450,000,000 marks on its general credit. It may issue a further sum equal to its cash reserve. Here we reach the dividing line. On all notes in excess of the foregoing aggregate it must pay a tax of 5 per cent. but its cash reserve must never be less than

one-third of its notes outstanding. Obviously the cash reserve is the proper criterion for fixing the limit of note issues at any particular time. The bank's capital has no more and no other relation to circulating notes than it has to deposits. Both notes and deposits represent the bank's credit in different forms.

Another difference is found in the fact that the German bank is managed by government officials who have no pecuniary interest in it. Although the property is owned wholly by private persons, they have no share in its actual management. Thus the officers of the bank are not moved by the desire of gain on the one hand, or by the fear of giving offense to borrowers on the other. Still another difference consists in the fact that the government has a proprietary interest in the bank's earnings, although not in its capital; and naturally it desires to get all the revenue it can from that source. So when a panic comes and there is a demand for more than the ordinary amount of notes, it exacts for the public treasury 5 per cent. interest on the excess. That is quite right in the case of a government which needs all the revenue it can get, which is not our case.

Another question much debated is whether note holders ought to be preferred creditors of failed banks. That they are so now is not generally perceived and is sometimes disputed. The fact is, however, that at the bank's birth the government not only takes from its assets a sum which it deems sufficient to pay the note holders in full in case of insolvency, but it provides that if by any mischance this should not be sufficient it shall have a first lien on the remaining assets for that purpose. So the question we are asked is, whether the note holders shall continue to be preferred creditors, as they always have been under the national banking act; or whether, under a scheme of asset currency, this preference shall cease. The burden of proof is on those who would make the change of practice.

Making note holders preferred creditors of failed banks is the common rule in Anglo-Saxon countries. It took root in the United States before the Civil War. Its first appearance on the statute book was in Connecticut in 1831, where it was enacted that in case of the failure of a bank the holders of its notes of the denomination of $100 or less should have a prior lien on the assets of every de-

scription. The underlying thought of the legislature was to protect the poorer classes of the community—those who are least able to protect themselves. It was a good motive then and is equally valid now, but the most cogent reason for giving a preference to note holders is that it seems to be necessary in order to make the notes circulate at all. If other means can be devised to make the notes safe and to convince the public that they are safe, so that they will pass without hesitation or question, then the preference now and heretofore given to note holders in this country may be dispensed with. Otherwise it should be retained.

This leads up to a suggestion made by Secretary Shaw in a recent speech, that the government should redeem all the notes of failed banks, both those issued on the present plan and those issued on the asset currency plan, and reimburse itself as regards the latter by means of a safety fund to be created in a certain way. This is the wisest suggestion that has yet been made by anybody in authority, and it comes at the psychological moment. It may seem startling at first that the government should pledge itself to redeem the notes of private corporations, but it does so now, on condition that it shall be secured against loss. The deposit of bonds at Washington is not the only way of securing the government. The deposit of money is equally effective. How much money is needed to secure a given amount of bank notes is to be ascertained by experience. This amount, whatever it may be, should be contributed by the banks themselves in proportion to their circulation. This is a matter of detail in which the advice of bankers will be most important.

The Indianapolis plan of asset currency proposes that the notes shall be receivable for all government dues, but that the government shall not pay them to its creditors without their consent. This would make the government responsible for the circulation in an indirect manner, since all failed bank notes would find their way through the tax office to the treasury. No individual holder could lose anything by them any more than by the present silver certificates. The government would recoup itself out of the safety fund, and the safety fund would recoup itself out of the assets of the failed banks, as under the Canadian system.

The chief advantage of making the government responsible

for the notes is that it would dissipate all fears as to the goodness of the circulation. It would bridge over the transition from the present decaying system to a living self-perpetuating one It is this transition that sets people shivering at the river's brink. "What would happen if the notes of one bank should turn out to be bad? Would not such a phenomenon, so unexpected, so out of the range of experience, so diabolical, start a run on other banks and lead to social convulsion?" Such is the thought that presents itself to the minds of people at first. Now government redemption solves this difficulty completely. It solves more difficulties than anything else that has been proposed, and it involves the smallest possible change in the method of insuring the notes of the few banks that may become insolvent—probably not more than 8 per cent. of the whole number.

The central redemption of bank notes is a much debated subject just now, and nothing else calls for more careful consideration. This is a question that concerns the bankers rather than the public. Under existing law national bank notes are legal tender in all payments to national banks. So in practice every bank converts into par funds the notes of every other bank. If the law required each bank to redeem the notes of every other one, it could not do more for its customers, and for the public in general, than it does now. Hence it is all the more necessary to provide facilities by which each bank may convert the notes of other banks into par funds, lest it should be choked with a currency not legal tender and not countable in its legal reserve.

I understand that some banks do count the notes of other banks as part of their legal reserve, although the law forbids that practice. Such a practice ought to be strongly repressed because it is contrary to law, because it leads to other infractions of law, and because it is opposed to sound principles of banking. Bank A may argue that the notes of Bank B must be good because they are redeemed on demand at Washington and at B's counter, and because they are backed by government bonds. Bank B may say the same of the notes of Bank A. Now it is conceivable that the cash reserve of each may be composed wholly of the notes of the other. In such a case the depositors in Bank A when they draw money will receive the notes of Bank B, and when they present

them for redemption will receive the notes of Bank A. They might as well have taken the notes of Bank A in the first place, or even better since they would have saved shoe leather by doing so. The same argument which justifies a bank in counting the notes of another bank in its legal reserve is equally valid for including its own notes in that category, which leads to the predicament of having no cash reserve at all. It is the old and mischievous fallacy of considering security for bank notes the same thing as payment of them.

Central redemption of bank notes now takes place at Washington, or ought to, but it has been rumored lately that the Secretary of the Treasury has suspended the practice. It is said that while promptly redeeming with public money the notes sent in for that purpose, he does not compel redemption by the issuing banks. This course, if it has been followed, involves an infraction of the national banking act, which requires that monthly notices shall be forwarded to the issuing bank of the amount of its notes sent in for redemption, and that the bank shall "forthwith deposit with the treasury of the United States a sum in United States notes equal to the amount of its circulating notes so redeemed." Failure to make this deposit involves a glaring violation of law on the part of the bank. Failure to enforce the law involves an equal violation on the part of the Secretary. The Constitution says that the President "shall take care that the laws are faithfully executed," and this applies to all the executive departments. They must not merely govern themselves by law, but they must see that all other persons and corporations under their supervision do so. To assume that the Secretary's duty is ended when the banks have been notified of the amounts due, is as inconsequential as Dogberry's advice to the watch to thank God they were rid of a knave.

A bank note is a promise to pay money. Central redemption is necessary in order that the promise may be fulfilled speedily, cheaply, easily. The banking system is an organization of credit, of which the bank note is one part. Anything which makes redemption speedy, easy, and inexpensive fortifies credit and builds up the whole system. Central redemption has also a reflex influence on the banks. It is in the nature of a tonic. It prompts each bank to maintain a good cash reserve and to keep its assets

generally in a liquid condition, in order to meet its obligations on demand. It tends to repress speculation and to prevent the lending of money to slow borrowers and on slow securities.

The importance of central redemption to the banks themselves being manifest, it must be added that bankers are the only persons competent to devise the machinery for it. They have personal knowledge of the "runaways" of bank notes. They know where the eddying currents of commerce bring them together in heaps, where they may be most readily offset against each other. Notes should be redeemed by clearing, just as checks are, and just as New England bank notes were, under the Suffolk system, the balances only being paid in cash. The places where they come together naturally should be chosen for central redemption. One-half of all the bank notes received at Washington are sent thither from New York. Therefore, if New York instead of Washington were the place of central redemption, one-half of the cost of transportation would be saved, besides the cost of packing, unpacking, recounting, red-taping and some loss of time and interest. Eighty per cent. of all the notes received at Washington are sent from six cities. Therefore, if these cities were chosen for central redemption, four-fifths of the present expense for transportation inward would be saved. Washington City was chosen thirty years ago as the place of central redemption, not for any commercial reason, but because the notes were there printed and issued. The replacing of worn and mutilated notes was the main consideration. But new notes for this purpose could be kept in stock by the assistant treasurers of the United States at each of the redemption cities as gold certificates are kept to be issued in exchange for gold coin.

Returning to my theme, "Our bank note experience of twenty years," is it not clear that the present system of note issue is doomed? But for two or three circumstances of an extraneous kind it would have been extinct ere now, for the want of United States bonds as security. One of these extraneous circumstances was the panic of 1893, another was the Spanish war. These two events checked the payment of the public debt and added $462,000,000 to the principal thereof. The extending of short-time bonds to the amount of $528,000,000 for thirty years was made for the purpose of keeping the bank circulation alive. This extension was

a glaring departure from correct principles of public finance and a violation of American precedents and was rendered possible only by the paralysis of the Democratic party in the elections on the silver issue. That party had been so stunned on the financial side of its head that it had lost even the power of criticising its opponent's mistakes. The Republicans were thus emboldened to issue half a billion of bonds, laying an interest burden of the aggregate amount of 60 per cent. on the taxpayers, to take the place of debts which might have been paid off at their early maturity at an interest charge not exceeding 15 or 20 per cent. and a bonus was paid to the bankholders in addition. The Republicans expected by this means to postpone the day of judgment for thirty years, but the result has not come up to their expectations. The new 2 per cent. bonds rose to such a premium in the market that the profit on circulation was only six-tenths of 1 per cent. over and above that obtainable from mortgage loans, and even this surplus can be gained only on condition of keeping the notes out all the time. Hence the necessity of using the money in the treasury as an additional jack-screw to keep the edifice from tumbling down.

At the meeting of the American Bankers' Association at New Orleans a resolution was adopted giving "unqualified approval of the enactment of a law imparting a greater elasticity to the currency system in order to make it responsive to the business of the country," and calling for the appointment of a committee to consider that subject and report at its next meeting. Such a report was submitted at the San Francisco meeting last week. It recommended a change in the kind of securities to be deposited in the treasury for circulating notes, making the Secretary the judge of the kind and amount required. This is not a change of system and the question is whether the selection of an inferior kind of security will impart elasticity to it. It will still be necessary for the banks to pay more money for the bonds than they will get back in the form of notes. It will still be incumbent on the bank's officers, in the interest of their shareholders, to watch the market, as they do now, and sell the bonds, either to secure a profit or to avoid a loss. The wants of trade will have no more bearing upon the note-issuing function when the bonds of New York City, or of the New York Central Railway, are deposited, than they have now.

But a change in the kind of security accepted for bank notes, and the adoption of an inferior kind, may have other effects. If the Secretary of the Treasury is to decide between different kinds of bonds, accepting some and rejecting others, and perhaps rejecting to-day what he accepted yesterday, his powers will be dangerously great. He will have control of the money market if he chooses, and he will be supposed to exercise control even if he does not. Even if he uses his power impartially and wisely, he will not escape criticism.

Conversely, the Secretary will always be subjected to political pressure to admit new securities to the favored list, and speculators will be constantly manufacturing securities to be put upon that list, or to fill the space left vacant by those withdrawn from the market. The Aldrich bill in the last Congress, which proposed to legalize the practice of taking other than government bonds as security for government deposits, defined the classes of bonds of states, cities, and railways that might be accepted. It was the opinion of Wall street at that time that the object of the measure was to create a vacuum of one hundred and fifty millions in the bond market to be filled by "undigested securities." That vacuum would be much larger if the San Francisco plan should be adopted. This elasticity would not be in the currency, but in the securities.

In the same newspapers which contained this news from San Francisco was a cablegram from Berlin reporting an interview between Herr Koch, president of the Reichsbank, and an American. "Your country," said Herr Koch, "has already taken long strides toward a sound monetary system in the repeal of the Sherman silver law as well as in more recent measures. This legislation has been dictated by a determination to keep the currency sound. But from our German experience we regard elasticity as being next in importance to soundness, and as being indeed indispensable for the circulating medium of a great commercial nation; and we think it would be of immense advantage for you to adopt some plan in addition to the check and deposit system, under which the circulation would adjust itself to the monetary needs of business."

These are words of wisdom. They mean that the United States ought to adopt a system under which bank credit shall be made available for circulating notes as well as for checks and deposits.

Bank credit, I affirm, does not enter into the currency system of this country at all, and we shall never have an elastic system until it does.

THE STRENGTH AND WEAKNESS OF AMERICAN FINANCE

ADDRESS DELIVERED BY ELLIS H. ROBERTS, EX-TREASURER OF THE UNITED STATES, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW YORK, SEPTEMBER, 1904.

FORTUNATELY, the United States is not asking for new loans. The government is not increasing its debt by long bonds or by exchequer bills for temporary needs. If in any month outlay exceeds income, the deficit is covered by previous surplus laid away. Individuals and corporations reach out for vast sums in loans, but the nation is not a borrower in any market. Its interest-bearing debt at the beginning of the fiscal year 1898 was $847,365,130, and the annual interest was $34,387,315. A loan of $200,000,000 was made by popular subscription for war purposes. Yet at the start of the current fiscal year that debt was only $895,157,440 and the annual interest $24,176,745. In the interval the government has paid the cost of the Spanish War, $20,000,000 under the treaty of Paris, and $50,000,000 on account of the Panama Canal. Now the nation stands on a granite basis of credit, and over the door of the treasury may be inscribed: "We are not borrowing here." This fact reduces the financial problem to simple terms. The government leaves the loan market alone. Enough factors remain, however, to make it worth while to study the strength and the weakness of American finance.

For a full discussion of our theme, we might perhaps be required to treat of the receipts and disbursements of the government. We may, however, in these partisan days, leave this branch to the orators and the press of the political parties, who will be quite ready to thresh out the straw to the uttermost.

In an ideal currency system, one would not expect to find, besides subsidiary and minor coin and the disappearing treasury notes,

six classes of money—gold coin, uncovered notes, certificates issued for gold, certificates issued for silver, bank notes, and legal tender silver dollars. Or only four classes might be named, to wit: gold and its certificates, constituting 44.1 per cent.; silver and its certificates, 21.2 per cent.; uncovered notes, 13.2 per cent.; and bank notes, 17.2 per cent. The financial architect would seek to be rid of uncovered notes and legal tender dollars, and might look askance at the large bank circulation.

The United States notes, at first and still in theory a forced loan, began without reserve behind them. The resumption act, which aimed to redeem them in gold, gave them a power for mischief as weapons for assault on the official treasure. Danger arose when the revenue was inadequate, and the treasury became impoverished. Peril ceased when a surplus was created, and the yellow metal flowed into the national coffers. In itself the United States note is weak; it gains strength as gold is put behind it. The practical banker may join with the theorist in the wish that it may pass gradually into the gold certificate. That change is going on without jar or friction on two paths: first, by the increase in the gold in the treasury, and second, by the use of notes of $10 instead of those of larger denomination. In five years the $10 notes have run up from just less than $100,000,000 on July 1, 1900, to $193,-459,321 in 1902, to $245,440,011 on the same date in 1904. The treasury gross gold in the same period from $423,577,971 rose to $681,838,821, and is now over $700,000,000. Thus these greenbacks have turned from large notes in chief part to be 70.7 per cent. in $10 bills for which the demand always, with rare exceptions, exceeds the supply. In the same five years additions of 60.9 per cent. to the gross gold in the official vaults have been made.

The share of the uncovered notes to the total currency is steadily growing less. From 33.6 per cent. in 1880, and 23.4 per cent. in 1900, it has fallen to 13 per cent. The danger from them has diminished in certainly as marked a ratio. They are to decrease, while the general volume is to increase.

Congress could without friction use at once $50,000,000 of the gold reserve for certificates of $10 and $5, as a substitute for United States notes offered for redemption, and in each succeeding year apply a like sum from the inflow to continue such change. The

redemptions of United States notes last year were $122,680,000 and the average for five years $101,231,200. It would be easy to transform half of this sum into gold certificates. By this process the United States notes would grow less weak, and before very long become in fact gold certificates, as they are now in essence, in the ratio which the reserve holds to them, or 43.2 per cent.

The silver dollars have of late been severely assailed in and out of Congress. They are denounced as excessive in volume and as a menace to the integrity of the currency. Demand has been loud for their redemption in gold, and for the reduction of their number by coinage into fractions. Predictions have been put forth that some official may, at his option, pay them for interest or some other high obligations.

Assault on a fortress does not prove that it is vulnerable, but it does challenge vigilance and defense. While additions to the silver dollars were constant, their force for evil or for good grew apace. The repeal of the act for the purchase of silver set a barrier to the current and checked it. The recent stoppage of the coinage of dollars fixes a limit to their volume, and permits a calm survey of their use and their abuse.

Silver dollars in circulation and not covered by certificates on July 1, 1900, were $65,889,346, and 3.2 per cent. of the total currency. The volume increased for three years, but the ratio fell to 3 per cent. of the total circulation. In the last fiscal year, including the coinage for treasury notes, the last volume became $71,561,684, or 2.8 per cent. of the total circulation. The silver dollars in the treasury reached the maximum from October to December annually, and the minimum in July or June. In 1900 the difference between summer and early winter was $8,203,467; in 1901 it was $10,422,985; in 1902 it was $6,651,358; in 1903 it was $9,794,447; and in 1904 it was $10,011,539. This is a margin of practical elasticity in these metallic dollars, and marks the currents of their use in the varying seasons. This elasticity is in so far an offset to the weakness of such coinage.

The critic has a right to say that his objection rests not only against the seventy or eighty million dollars in circulation as such, but also against the 460 or 470 millions covered by certificates. The demand for dollars and certificates makes sturdy answer. In the late

autumn, the treasury finds the drain on these kinds of currency exhaustive. Its ten offices in September, 1900, held only 55,006 silver dollars and $3,646,159 in silver certificates. Since then the minimum holdings have not fallen so low. Dollars were $1,405,631 in December, 1902, and $898,275 last September; while silver certificates in the autumn months of 1903 and 1904 were $4,271,-562 and $6,192,783.

These conditions are created by the movements of the crops, which call for dollars and small bills. The treasury prepares by husbanding such resources and on August 22 last, before the autumn shipments began, had in its several vaults in United States notes, nearly all $10, $15,716,020; in silver dollars, $22,641,903; and in silver certificates, all $1, $2, and $5, $7,100,458. This is a total of over $45,000,000 available for putting on the market corn and wheat and other grains, provisions, cotton, and sugar. Great as this sum is, if it shall fully meet all the requirements of the season, those who have in other years been troubled to secure small currency will rejoice. As far as it goes, it will illustrate the measure of elasticity possible with forethought and vigilance under our system. To that extent the weakness of rigidity is mitigated.

Bank notes on July 1, 1900, issued by 3,732 banks, were $300,-115,112 and 14.6 per cent. of the total circulation, and became at the outset of this fiscal year $433,595,888, issued by 5,386 banks, and 17.2 per cent. of such circulation. They have thus increased faster than the currency as a whole. Students of finance regard them with very different views. To very many our banking system seems the best in the world. By others bond security for circulation is denounced as unduly expensive, viciously rigid, and unresponsive to trade necessities. The limit of the monthly reduction to $3,000,000 is especially offensive to them. Not all such critics, but many, seek a substitute in currency based on general assets. Some thoughtful financiers look with alarm on the rapid and continuous increase in bank notes, and object to any device for adding to them. The suggestion is urged for the gradual substitution of government certificates covered by gold and silver. Bankers are questioning the profit of putting out circulation, and some great institutions restrict their deposits of bonds for that purpose to the lowest amount permitted by law.

While less than one-sixth of the entire circulating medium, bank notes give rise to by far the greater share of discussion in the field of the currency. Is such currency a deformed and nervous sister in the family, requiring most of the expert care of doctors? Or is it Cordelia among Lear's daughters, constant, faithful, and true, dispensing comfort and blessing? Absolutely safe as they are, everywhere current for purchase and payment, these notes are the storm center of financial controversy.

Of late another weakness in our currency is vigorously exposed. The paper money is not clean. Banks are not willing to pay the charges for transportation to secure new bills; if they were, the face of the notes could be kept more nearly fresh as the bedewed morning flowers. No general agreement on such a policy is likely. Can Congress be induced to spend half a million or a million dollars a year for the increased redemption, the larger number of new bills, and the cost of shipment in and out? This answer can hardly be given here and now.

Instability is not a virtue in finance. In this country no topic is too sacred for discussion, and statesmen and professors, editors and orators have not had the field of the currency to themselves. Everyone who can sharpen a pencil or own a typewriter or get an audience in a club or on a corner, can tell where Hamilton was wrong, where Congress has blundered, how useless is our nation's experience. The halls of legislation are open to every scheme. The theorists who assume infinite wisdom, and discern only ignorance and vile motives in opponents, are always busy. The cynics clothed in malice, who find nothing good in existing conditions, and the tuft hunters who prefer foreign methods to anything American, never fail of occupation. At the last session of Congress, which was not very prolific, no less than twenty-one bills aiming to change our currency were introduced. If not one was passed, every project sought to unsettle in some way existing conditions. This threat of instability is one of the penalties of the great blessings of free speech and unstinted right of petition. The day must have its shadow as well as its sunshine.

The confession that weak links can be found in our financial chain shall not drive us into pessimism. We know the growth and the reserve of strength. Under the act of March 14, 1900, every dollar

is equal to every other dollar, and all are interchangeable. Because they are most in use among all the people everywhere the small notes are in greatest demand. If conditions point at all to a premium, the ones, twos, and fives will command it first. But the level is well maintained. Whatever winds blow or storms beat, our currency has a surface as clear and even as a mirror. That surface is not of mercury, shifting and undulating; it is formed of the minted gold.

The stronghold of our financial system is its actual gold, as well as our statutes. The world has about $5,500,000,000 of this metal, of which the United States has in its stock $1,342,422,740. In the last reported year, the world produced less than $300,000,000 of which our mines gave $80,000,000. Our treasury holds $700,000,000 in gross, and our banks, national and other, have $300,000,000, approximately. So over one-fifth of all the world's gold is in the United States, and the bulk of it in the banks and the treasury. The increase in gold in both forms in our currency in five years has been just less than $300,000,000 ($299,853,457), and in the last year from August 1 to August 1, $137,727,920. The charge is put forth often in spirit, and sometimes in words, that we are extravagant and wasteful in the possession of so much of the precious metal. Are we?

A leading financial journal of this city quotes the president of one of the largest banks in San Francisco as alleging that it costs $20 to get a dollar of gold out of the ground. Was the metal all that the picks of the miners and their self-sacrifice took out of the earth? Did not the argonauts of 1849 and their successors create the California of to-day? The ranches, the orchards, the wheat and the fruit, the factories and shipyards, the cities, the churches, the universities, the civilization of that prosperous commonwealth, are a part of the harvest planted by that $20 of the miners.

A writer in the *Nineteenth Century* alleges that in Australia the balance in gold mining has been adverse, and in the same review we read that on the whole gold discoveries have not been of use. For all fields response may be given on the same lines as for California. Is not California now, is not Australia, worth all it cost? But we are not studying whether gold prospecting or gold mining as an industry is profitable or the reverse. Loss may befall

the miners in direct results, and yet by extending population, opening up new districts, creating new centers of production, they may add largely to the welfare of mankind.

Quite another question is whether the supply of yellow metal in this country and in the world is in excess. That problem is important and far-reaching. We are to note that gold here is in the ratio of 44.9 to the total currency, while in Great Britain it is 70; in France, 62.12; in Germany, 66.10; in Russia, 87.71, and in Austria-Hungary, 68.90. In all these countries combined, gold is 69.6 to the total circulation. If the world's experience is to be accepted our gold is not in excess, although our whole volume of money may be too great. Gold, whether in coin or certificates, becomes elastic as currency just to the extent that it comes to the treasury and goes out from the vaults. This counter-flow has no limit save the operations of trade. No payments or deposits in this form will be rejected, and the treasure will be held intact until the public use draws it out. Coin and certificates are interchangeable, and elasticity may assert itself to any degree. Our total circulation per capita at $31.06, exceeds that of every other nation save France, where it is $39.22. But our industry and enterprise and local traffic also lead in the comparison. The question is grave whether our currency is not in excess of our needs.

American finance connects itself with world movements. While we cannot follow the debate relative to the profit of gold mining, we must recognize the fact that among the great commercial nations the yellow metal is the only instrument for the final adjustment of trade differences. The experience of mankind has chosen it for that purpose, and there is no other instrument available. A few countries still cling to silver, but they all show signs of adopting the richer metal. Thus gold becomes more masterful. Those who put themselves in hostile array, denounce it as costly, and doubt the value of discovery and production, are bound to provide, at least in theory, some other tool for settling the world's commerce. The era of rude barter has passed away. The stress of trade insists upon the best machinery.

In the last fifteen years we exported in gold $890,231,329, and imported $845,452,765. From 1890 to 1896, inclusive, every year showed an excess of exports to an aggregate of $273,961,117. In

only two years since then, 1900 and 1903, were the exports greater than the imports, $5,802,143 in all; while in the other years of the period the imports were $234,984,696 in excess. In the last fiscal year, in spite of exceptional foreign payments, the imports surpassed the exports by $17,595,382. So the exports for the whole period were the greater by $44,778,564, and this is only equal to our own production of the metal for seven months. More significant still, it is only 5 per cent. of the outward movement for the period.

Yet the full sums of imports and exports were carried across the ocean at great risk, heavy cost for freight, and not a little loss by abrasion. Why should this treasure be carted back and forth between nations, as the banks of this and other cities used to deliver money to each other? Is it not possible to frame a system by which only the differences may be paid in metal at proper intervals? Surely it would be cheaper to pay the balances than the gross sums, as the clearing houses daily testify.

Why cannot an international clearing house be organized? Perhaps jealousy will forbid the selection of a single city for the purpose, as the Greek cities were rivals for the deposit of the offerings to Apollo. The international organization may well have its vaults in London, Paris and Berlin, as well as in New York, and the treasure can be divided in the ratio of the gold of the several countries. The certificates of the four vaults can be interchangeable. The barbarism of shipping kegs of metal east and west over the Atlantic may go with the method of the mummies and the cave-dwellers.

American finance does not stand alone, a Teneriffe in mid-ocean, a Shasta or Ranier or Mont Blanc rising in solitary majesty among their ranges. It is the vital current of the activity of the people. Its strength is not in theory or in petty technicalities. It is strong with the brain and brawn of 82,000,000 citizens; with the varied resources of mine and soil and forest and running waters; with the sheep and horses on many ranches and the cattle on a thousand hills; with coal and iron and all their products; with wheat and corn and sugar and cotton; with the inventive minds and skillful fingers of efficient artisans; with forge and factory and dynamo and motor; and not least with school and college, with university and church. Financial strength is in wealth of every kind, but not less in the purest morality and the worthiest character.

THE BANK AND THE TREASURY—THE TWO GREAT PILLARS SUPPORTING OUR FINANCIAL SYSTEM

ADDRESS DELIVERED BY FREDERICK A. CLEVELAND, PH.D., PROFESSOR OF FINANCE IN THE SCHOOL OF COMMERCE, ACCOUNTS, AND FINANCE, NEW YORK UNIVERSITY, BEFORE THE PENNSYLVANIA BANKERS' ASSOCIATION, AT ATLANTIC CITY, OCTOBER, 1904.

A CENTURY of adaptation to new and ever-changing social and industrial conditions has given to America some remarkable institutions. In none is the strenuous character of the people more strongly marked than in our financial system; in none have we developed greater possibility for solidity and strength than in those concerns organized to supply the increasing demand for current funds. Living amid great natural resources, hampered for lack of capital and industrial equipment, working under conditions requiring intensity of effort and closest economy, the balance of prosperity has been swung by two contending forces—the one working for security or protection in the enjoyment of wealth acquired, the other taxing present resources to the utmost to make the future conquest over nature the more rapid and complete. An inventive people, we have exercised our best talent in devising ways and means for doing business, not on our own capital, but on capital acquired in exchange for credit or contracts for the future delivery of money. The result has been at times to carry investment judgment beyond all reasonable possibility of safe return.

Nor is this situation an unnatural one. With teeming riches awaiting only the application of capital for their recovery, inducement to promotion and credit investment has been great. But prospective money returns have not always been realized within the term of a loan, and failure in judgment has resulted in inability to make money delivery—in failure to meet credit obligations. Such failures, however, have not alone been due to overestimates of the industrial product. In many instances the rewards of nature have surpassed all calculation; but the money returns required by credit contracts have depended quite as much on market price as on quantity or quality produced, and the market has been subject to world-conditions which the parties to the contract could not foresee. Varying conditions of market price more often than those of production have made necessary a wide margin of safety in credit

investment. In each period of increased world-activity, of advancing prices, and larger profits, capital has been more easily obtained on credit. With each period of world-depression, capital has become more conservative, forcing reorganization and readjustment. It is out of this struggle between the forces of promotion and conservatism that our credit institutions have arisen.

The guiding principle of the American people in the organization and control of the institutions of current credit has ever been and is to-day to give to capital the highest utility compatible with safety. Proceeding from this principle, alternating in their control between the forces of conservatism and those of credit expansion, we have developed a system which is unique—a system in which both our *money* and our *commercial funds* are on a credit base.

Our money is largely credit money, and this is issued by an agency of central government which has no banking power—the United States Treasury. Our commercial credit is issued and controlled by private, locally independent institutions—our commercial banks. More vividly to portray the situation of our great credit system, it may be said to be a business device or structure supported by two independent pillars; the one a column or pillar consisting of $1,500,000,000 of credit money, and this resting on the gold Treasury reserves; the other a column or pillar of about $10,000,000,000 of bank credit, resting on individual bank reserves; on these two great columns is superimposed from $30,000,000,000 to $60,000,000,000 of private business credit that looks to the "soundness" of the credit of these two institutions for support. The problem of to-day is to make this system a safe one at all times with which to do business; to keep the foundations of these two great pillars sound, and at the same time to give to the system itself ability temporarily to contract and expand according to the varying needs of the country.

From the time of the Resumption Act of 1878, the credit money system had been growing gradually weaker by expansion of issues. In the face of the gold-standard measure of 1873, silver issues and silver obligations multiplied. The pillar of credit money was allowed to increase in weight, and the superstructure which rested upon it, without strengthening the Treasury reserve—its foundation. The federal administration was made responsible

for maintaining the parity and financial integrity of credit money issues of government, while Congress, by legislation for silver inflation, made the task more difficult. All went well, however, till 1893, when failing revenues forced President Cleveland to choose between using the loan power in his hands to obtain gold to repair the fast disappearing foundation of the credit money column, or permitting the national credit structure to collapse. He chose the wiser part—to maintain integrity of Treasury issues, and to let the country decide whether or not the gold standard should be maintained and the past policy of credit inflation should be abandoned. The result was a vote supporting the Gold Standard Act of 1873, forcing a repeal of conflicting legislation. By the act of 1900 the gold-standard reserve was broadened and strengthened, placing practically all the resources of the nation at the command of the treasurer, if need be, to protect the financial integrity of the currency.

With each recurring period of financial strain the soundness of our institutions of commercial credit has been brought to a test. Under the National Bank Act these have proved quite as sound as the banks of other countries, but, as with them, "soundness" has ever been at the expense of "elasticity" in commercial accommodation. While the banks have shown themselves able to take care of themselves, it has many times happened that their customers have been deprived of much-needed funds. It is generally admitted that our commercial banks have not been able to meet the varying needs of business for current "cash." The great financial issue before the country to-day is, How can we further adapt our currency and banking system to the fluctuating business demand? It is with reference to this question that the *bank* and *Treasury*—upon whose reserves the two great pillars of our system rests—will be discussed.

Any intelligent consideration of the problem of elasticity must proceed from inquiry as to the amount of adaptation required. As to this we may never have complete data. Fortunately, however, we have reports and statistics from which a safe approximation may be reached. The Treasury Department publishes statistics of changes in money circulation. Federal and state reports also give a fair view of public fiscal needs. We have data that are considered reliable with reference to the increased and decreased money supply

by importation and exportation, by issue and redemption. The national and state-bank reports give us a reliable basis for judgment as to the increasing and decreasing demands for credit funds and for money as a means of payment. The Comptroller of the Currency has also made several inquiries with reference to the daily averages of deposits and withdrawals from banks by months.

From Treasury statistics it is found that the greatest variation in money circulation within a period of a single year since 1890, allowing for the average rate of increase, is $244,000,000, or about 10 per cent. of the total national money supply. It would seem, therefore, that the fluctuation in the total money supply of the country is not a serious matter—that this increasing and decreasing need in the future, as in the past, may readily be met through the present agencies of "issue" and of "importation." But the fluctuations in total national money demand as compared with total national money supply are not as significant as are the variations of supply and demand between the several financial groups within the nation. With our present monetary statistics demands between financial sections and groups may be completely lost sight of. For example, within a period of a year the Treasury may show a monetary loss of $250,000,000, while the bank reserves may show a gain of equal amount. These fluctuations would not in any manner affect the total money supply of the country. Again, the banks may lose $250,000,000 from their reserves and the money in circulation among the people may increase in like amount. Such fluctuations would be lost sight of in an exhibit of national supply and demand. Nevertheless these are the fluctuations in supply and demand which every year rise up before the thoughtful banker like a nightmare.

Giving consideration first to the fluctuations in current money demands of the Treasury, the widest variation from the average increase in fiscal needs during the last fifteen years has been $160,000,000. This amount is well within the customary money balances of the Treasury. But, assuming, as now happens, that money demands on the Treasury may increase while the revenues are decreasing, this Treasury balance may be threatened with extinction. Nevertheless, the problem of adjustment of Treasury resources to Treasury needs in itself is not a factor disturbing to business Through the ample loan powers of the Treasury, money may be obtained by

importation at any time that a money surplus in the vaults of banks is not available. It is only when the American money rate is low, when the money stock of private institutions is so large that they can afford to sell at rates far below the usual commercial rate, that the fiscal needs of the Treasury will be supplied from the banks. In other words, when the government is forced on the world's market to obtain funds for its own needs, importation will serve to strengthen the national money market. When loans are taken in America, such investment serves to deter speculative excesses coincident with a large private surplus. The monetary disturbances that in the past have arisen from Treasury needs have been due to threatened attack on the financial integrity of credit issues, or to the calling-in of loans previously made by the Treasury to the banks. The purely fiscal transactions of the Treasury have served to strengthen rather than to weaken our institutions of private credit.

The only fluctuations in money demands that are serious, and therefore the only ones which from the standpoint of elasticity demand consideration, are those made by the banks themselves as a means of supporting their own credit accounts, and those made by the people for "till cash" and pocket money. These two demands may be treated as practically the same, since the method by which money is obtained by the people when in need of cash is directly or indirectly to draw on the banks. The purpose of selling commercial paper or other bankable assets to a bank is to obtain current funds for use in business. Under ordinary circumstances a customer prefers his current funds in the form of a bank account, but when occasion requires, the bank may be asked by the customer to pay its account, and this money is withdrawn from the banking reserves. The banks stand in the position of a money market to the people. The banking business is one of selling money "short," and then making delivery "on demand." It is through the process of making delivery on these short sales of money, by the banks to the people, that the money reserves of banks are depleted.

The largest fluctuation in average increase or decrease of reserves of national banks during the last fifteen years was $155,000,000. This was under conditions of extreme monetary disturbance and a general condition of doubt, which in many localities amounted to actual panic. Assuming that this fairly represents the maximum

fluctuation in money demands on national banks, and (since the national banks are depositories for private banks, state banks, and trust companies) assuming that the demands made on other banking institutions would not be larger in proportion to their capitalization, the extreme fluctuation in money demands made by all banking institutions would not exceed $375,000,000. This, therefore, may be taken as the degree of elasticity required in the *money* circulation to meet the needs of banks, and through the banks to meet the needs of the public.

Turning to the question of elasticity for which provision is to be made in the other form of funds used by the business community—viz., bank accounts—the same process of reasoning may be followed. Taking the statistics of national banks for the last five years as a basis for calculation, the largest variation from the average increase or decrease recorded within fifteen years has been about $350,000,000. This variation also occurred under circumstances of great financial stress—circumstances not only of doubt as to the paying ability of the banks themselves, but also of doubt as to the ability of the government to maintain gold payments on the credit-money used by the banks for reserves. These circumstances may never again obtain. Assuming that this extreme variation may be taken as a safe basis for estimate of the maximum fluctuation in demand for national bank-credit accommodation, the extreme variation to be provided for by the system would be about $875,000,000, or about 20 per cent. of the average amount of bank-credit at the time outstanding.

Again going to the statistics of average daily fluctuation in deposits and withdrawals by months, a somewhat better basis for calculation may be found within narrower periods of time. From the investigation made in 1903, it would appear that the average daily demand made on national banks is about $226,000,000. That this average daily demand by months fluctuated from $200,000,000 per day to $258,000,000—in other words, from the month of January to the month of August 1903, there was a fluctuation of nearly $60,000,000 in the daily averages. It also appears that the total amount of funds provided in the form of bank accounts changes hands on the average about once in fifteen days—that is, that the average length of time for which the business man

provides current funds needful to his business is about half a month. Assuming that $60,000,000 is a maximum fluctuation in the daily averages of demands on national banks for credit accommodation, and, further, that the active accounts of all commercial banking institutions is equal to about $6,000,000,000; assuming, again, that the fluctuations in other institutions are in like proportion to those in national banks, and that the average period for which provision is to be made is fifteen days, this would give a maximum fluctuation in current demand for loans when the banks are able to supply all demands amounting to about $1,800,000,000, or about 30 per cent. of the active accounts outstanding. This would seem to be an extreme estimate as to elasticity in bank credit accounts required.

With both the *system* and the *elasticity required of the system* before us, we are in a position to consider how the two great institutions which make up the system may the better be used to retain the quality of structural soundness which it has acquired by a century of national education and legislation, and at the same time to enable them to meet the fluctuating business demand for funds both in the form of money and in the form of bank accounts in such quantities as may profitably be used. That the Treasury cannot provide the people with credit funds goes without saying. Even money demands cannot be supplied by the government except through loans. Through obtaining loans is the only way in which the fluctuating business demands can be met under any financial system. In France and Germany—in fact, wherever the government is also a banker—loans may be made to the people direct. But under such a system as ours, in which the government has no institution of commercial credit, the only manner in which the government can come to the support of the market is through banks owned and controlled by private parties.

Since both the *money demand* and the *credit demand* fall immediately on the banks, it is to these that we must look for the means necessary to supply both money and credit to the people. Under the American system, how may the banks the better supply the fluctuating money and credit demands, and how may the Treasury best lend support to the banks without weakening its support to the credit-money issues of the government? The new relation proposed, and which finds many advocates among national

bankers, is "that the Treasury be required to deposit all surplus funds in the banks over and above the currency requirements." The reason urged in support of this proposition is "to prevent the money of the country being locked in the public vaults."

In opposition it is said that the reasoning by which the above conclusion is reached proceeds from two fallacies: first, that the money held by the Treasury is abstracted from the money stock of the country, and therefore operates to cripple business; and, second, that greater elasticity would be given to bank credit by having the revenues of government deposited in commercial banks. The popular notion that money in the vaults of the government is abstracted from the money stock "of the country" is erroneous. Assuming that $150,000,000 were the average reserve carried in the Treasury, that $100,000,000 were the average money reserve carried in the vaults of the several state and local treasuries, this average reserve, amounting to $250,000,000 would be taken, not out of the money stock available for business in the United States, but out of the money stock of the world. If originally the Treasury reserves had been suddenly abstracted from circulation in the United States by business necessity, this would soon become equalized through gold importation; and after an equilibrium had thus been established, this reserve would no longer be a factor in the money market. Only the fluctuations or variations in this Treasury reserve is to be considered as reaching the exchanges. An increase in Treasury reserves would operate to decrease the supply for other purposes; conversely, a decrease in physical money surplus would operate to increase the supply outside of the Treasury. The effect of this increase or decrease, it is true, would first be felt by persons or institutions of first contact; but should the amount of the increase or decrease affect the current funding needs of these persons or institutions of first contact, the supply or demand would soon be passed on through the market and the equilibrium again restored. The so-called locking up of reserves in the United States Treasury is more a matter of public concern for the people of Europe than it is for the people of the United States, since it may by us be used as a relief fund when needed, while others have no direct control over it.

The second fallacy is quite as apparent. To make the commer-

cial bank the recipient or depository of government funds, when the government itself is out of the banking business, cannot add to the elasticity of bank credit. If the government deposits were to be kept at a uniform amount, this amount would soon become absorbed in business, and the bank reserves would soon become reduced to the usual working proportion. Whenever an extraordinary demand for money or for credit funds arises, the bank would be in no better position to meet this demand than before. But the revenues and expenditures of government are not uniform. Were the revenue receipts and payments to be made through the banks, and the banks made the depositories of the government, this would be an increasing cause of monetary and credit disturbance, since it often happens that the banks are hardest pressed, and are required to keep the largest money reserves for their own protection, when the expenses of government are in excess of the revenues and the Treasury surplus is running low. If the banks had been the fiscal agents of government within the last year, it not only would have been necessary for them to have paid for the Panama Canal purchase, and to have arranged for the other extraordinary payments, but they also would have been required to meet a deficit of $14,700,000 in current revenues. That is, this much of the government surplus must have been withdrawn from the banks as a means of protecting its own credit. Such an alliance between the government and the banks would have reduced rather than increased elasticity in the system.

So long as the government remains out of the banking business, the greatest elasticity obtainable must come through the collateral support which an independent treasury may be able to give to independent commercial banks. The fact that the national Treasury carries in its vaults from $100,000,000 to $250,000,000 of money over and above its currency requirements, and that this may be kept free for collateral support to the banks, suggests one of the ways in which the government may aid the banks to meet an increased money demand, and at the same time may permit the banks to increase their credit accounts to customers. It usually happens that the Treasury surplus becomes largest in periods of low money demands—times when the banks are giving an inordinate expansion to their credit. For example, from June 30, 1899, to June 30, 1902, the

ordinary receipts of the Treasury exceeded the ordinary disbursements by $245,000,000. During the same period the bank credit of the country expanded about $2,000,000,000. If the government had deposited this excess in the banks it would have still farther enhanced speculation and made the credit situation the more difficult to support after a climax had been reached. From June 30, 1902, to June 30, 1904, the ordinary receipts of the Treasury exceeded the ordinary expenditures by only $12,000,000, and during the last year there was an actual deficit of $41,700,000. This falling-off of government revenues was coincident with great financial pressure on the banks. To have put the government in a position where it had been necessary to throw this burden of decreasing revenue on the bank would have meant certain ruin to commercial credit.

The net result of the independent treasury system during the years referred to has been to bring into the United States in time of greatest prosperity, and to keep here during a period of credit expansion, at least $200,000,000 in gold, which, if placed in the vaults of banks, would doubtless have caused still greater credit expansion, and at the same time would have set up an exportation of gold. Even if no financial aid had been given to the banks by the Treasury, the result of the operation of the independent system would have been beneficial. The same effect may be traced through the recurring periods of credit expansion and credit retraction since the Civil War.

But the history of the last two or three years teaches a lesson which should never be forgotten by the banks. When the effects of speculative loans caused credit reaction, and business conservatism began to demand settlement of contracts of money delivery, and when increased pressure was brought upon the banks for payment, this would doubtless have proved ruinous, not only to the banks, but also to the commercial and industrial interests of the whole nation, had not the national Treasury responded to pleas for aid from commercial credit institutions. A volume of credit has been piled up which was too great for the banks to support with their present capitalization. The crumbling foundation of bankers' reserves, a considerable portion of which was borrowed, would doubtless have gone from under and given way to financial stress,

or the burden of supporting them been thrown on the banks' customers in their efforts to save themselves, had not the government transferred over $100,000,000 to their support. Had the prescription above referred to, and usually given as a remedy for financial weakness, been followed, had the government previously deposited its surplus in the banks during those years of so-called prosperity, instead of giving to the great national credit structure stability and power of endurance, it would have had the effect of adding nothing to the capital or to the relative strength of the banks; it would have been received and used by the banks in lieu of capitalization; it would have made the superstructure still more top-heavy —would have placed the system beyond all possible remedial aid without a long period of reorganization and readjustment of credit relations to paying ability.

The independent Treasury gives to the American system a strength that is not attainable under any of the much-lauded foreign financial devices. The fact is that we have not used the independent Treasury to its highest advantage. The deposits made by the government with banks are loans without interest. So long as the government does not call these loans there is no inducement for the banks to pay them. On three different occasions, from 1899 to 1903, the Treasury has helped the banks to support their financial burdens. In each case the strain upon them, the so-called inelasticity, was due to an over-issue of their own credit, and to inability to make the money payments demanded without a violent contraction in credit accommodation. The government has stepped in to prevent this contraction. But when the stress was past, what then? Did the government again gradually repossess itself of the moneys gratuitously loaned? Has it again reclaimed the means by which assistance was rendered? No; following just such reasoning as has been quoted, the loans remained with the banks still without interest. The Treasury was able again and again to come to the relief of the banks by reason only of its constantly increasing surplus.

The weakness in the situation lies in the failure of the banks to reduce their temporary loans from the government when the emergency is past, and in the Treasury's failing to call in its demand loans when the reserves of the banks become adequate to

support their credit. In July and August the bank reserves piled up till they were becoming a source of possible weakness. When the Panama Canal purchase was to be settled for, when the government revenues began to fall off, instead of demanding a return of loans to the banks, and thus reducing the large surplus reserves which the banks had accumulated and of which they were complaining, the government preferred still further to reduce the reserves in its Treasury vaults, calling on the banks for only such an amount as seemed necessary. During the month of September there was a gradual withdrawal of bank reserves to supply the business need. Under circumstances of weakening bank reserves and of gradually decreasing revenue of government, with the consequent disappearing of the Treasury surplus, the banks may not only be deprived of collateral aid in time of financial stress, but may be required even still further to weaken their money reserves by making payments to the government. Under such circumstances, the banks would be left to their own resources, with the government money demand as well as the public money demand to supply. The result would be that in their own protection the banks would be forced to contract business accommodation in such a way as to make the present practice positively dangerous.

At no time in the history of banking were the time and circumstances more opportune for Treasury support to banks than in 1902 and 1903. At no time in our history might the Secretary more wisely have withdrawn the government deposits than in July and August, 1904, when the money reserves were piling up in the vaults of the banks. The effect of failure to do this has been twofold: (1) the cheapness of money has caused an exportation of gold; (2) the low rate of call loans has caused speculation. In September we have had the result made apparent—a concurrent flow of money to the interior and abroad, and at the same time an increase in speculative activity. Thus we again have a period of increasing credit expansion and decreasing bank reserves. These movements have not proved threatening, it is true, but there seems at least a possibility that the banks may again call on the Treasury for collateral aid before another season is past, and under conditions which would require the Treasury to turn a deaf ear. Following a practice by which the government loans its surplus to the banks

without interest or at a rate below the market, the continued aid of the Treasury to the banks may depend on the exercise of discretion by the Secretary. If, however, the government were to charge the bank, not an exorbitant rate, as would a money-lender in time of stress, but the usual commercial rate, the banks would promptly return the loan when money falls below the usual price. No longer would it be the marvel of European bankers that the call money rate may within a day rise to phenomenal heights. While the government was in the attitude of offering to loan at five per cent. the rate could not rise far above this figure. In either case, whether by exercise of official discretion or by charging a rate which would make the restoration of reserves autonomous, the Treasury support to the system would not be weakened. On the other hand the money market would be steadied.

But even if the Treasury never had a surplus to loan to the banks in periods of emergency, we have in our present system possibilities for increasing circulation for current needs that are not inherent in foreign systems. This is in the so-called issues of banks. If the bank has unencumbered resources (mind you, *unencumbered* resources) necessary to obtain a government "deposit loan," these same resources may be pledged for a loan from the government in the form of "bank-notes." July 1, 1904, the Treasury reported that there were $449,000,000 of bank-notes in the hands of the banks or in circulation. These issues alone were more than ample to meet all fluctuation money demands of the country. The only trouble is (as in the case of a permanent policy of depositing government surplus with the banks) that, when the banks are in trouble, notes are not available. Like the government deposits, they have already been absorbed in current circulation, have all been used to support the ordinary banking operations during periods of low money demand, and in time of strain the banks have their best securities tied up for funds with which to do business when there is no strain to be met. In time of extraordinary demand they are left helpless.

Why should this be so? Why might not these notes be used in such a way as to permit an increase of at least $400,000,000 in money circulation, and a simultaneous increase of at least $1,600,000,000 of bank credit accounts at any time that an extraordinary de-

mand might be made for funds? Many bankers have suggested, as a way out of the difficulty, that a tax be placed on issues. Secretary Shaw, in his Chicago address of a year ago, pointed to this. Require the banks to pay a tax equal to the commercial rate of interest (let us say 5 or 6 per cent.) on all issues over and above a determined minimum—or call it interest on the "issue loan" of the government to the banks—and the banks would not encumber their assets except when money demands were above that rate. These suggestions were made with much force. The result may also be predicated from experience. As the trustee of collaterals, and as the department of issue and control of the bank-note, the Treasury might thus lend as much support for the expansion of money circulation and current credit accommodation as the system itself would require without relying at all on its own surplus revenues or credit money reserves.

Aside from making the bank-note circulation in large part an emergency currency, aside from giving elasticity to our national money and credit system, the effect of such a law would be two-fold. By taking a large part of the present issue of bank-notes out of circulation, except when an extraordinary demand arose, the ordinary demand must be supplied, and the amount taken out of circulation must come from some other source. This would necessitate an increase in gold certificates or other forms of money issue. The ordinary money requirement would be met, but it would not be met by bank-notes. The necessary money funds would come either from an increase in issues of government or by importation. The second result that would obtain has a bearing on the financial strength of the banks themselves. If the banks were not encouraged to encumber their best resources in time of low money demand; if, it may be said, they are required to retain their capital in such form as to make it available for support of their credit, and were permitted to deposit "gilt-edged" securities of such kind and quality as might be prescribed by the Treasurer for bank-notes in time of strain, the support which is now given to the credit of government in the form of increased strength to the bond market would then be given to the banking business. In other words, the net result would be an increase of banking capital for banking

purposes—a result which in itself would be desirable as a means of supporting greater elasticity in credit accommodation.

Another conservative principle is contained in the American system that is not afforded by that of any other country. As the one institution permitted to issue credit money, the Treasury gives to the people a form of currency more convenient in use than gold and less expensive to itself. The silver dollar, the greenback, the silver certificate, etc., cost the people who use them just as much as gold coin or certificates, but the cost of these credit moneys to the government is less. By means of their issue the government is able to carry on its own business and to decrease its interest-bearing debt about $600,000,000. What the Treasury stands pledged to do, and what it is necessary for it to do under our system, is to protect these credit issues—i. e., to make payment in gold when gold is demanded. So long as no doubt arises as to this, there can be no financial disturbance on that account. But there may be a distinct advantage to the money and credit system. If at any time our foreign balances demanding settlement become so great as to cause a drain on bankers' gold reserves, it may become necessary to stay the tide of exportation as a means of protecting the credit system. This result will be effected through the demands made by the banks on the United States Treasury for payment of government credit issues. At such time the government will be brought into the gold market as a means of meeting its own demand debt, and gold may be had for the support of credit of the country at a rate more favorable than it could be had by any individual or private banking corporation.

No greater fallacy was ever put forth than that which concludes that a government which is not in the banking or loan business can supply money capital for private business. If all the gold coin of the world were stamped and issued from the United States Mint, so long as the business habits of our people remained the same, no greater amount of gold would find its way into American channels of trade. On the other hand, if the government did not issue or coin a dollar, the people would have the same amount of money which they now have with which to do business. Our circulation would not increase or decrease in either case. Instead of buying gold and taking it to the mint, we might buy foreign coins; instead

of retaining the currency issued by the government or that put out in payment of its own obligations, we might have some other form of currency. But the usual amount of currency would be supplied from one source or another by coinage, by issue or by importation, in exchange for products of our mines, our manufactures, etc. What the government can do and does do is to make the funds ordinarily needed conform to a standard adopted for our own use, and to protect these in their financial and physical integrity against impairment. More than this, the government may provide a means by which extraordinary demands for money may be met without resort to importation. It may make provision for meeting this fluctuating demand; it may make this extraordinary money supply more readily obtainable than might be if our traders and manufacturers were required to go abroad for it. This may be done either by direct loans of money to the banks from the Treasury reserves, or by temporary credit money issues to the banks. Instead of the banks pledging securities abroad, the way should be opened to pledge them with the Treasury and thereby obtain any amount of money for such extraordinary circulation that is needed without disturbing domestic and foreign trade. And for this purpose no system is so well adapted as the American system, having for its main supports the two independent financial institutions—the independent commercial bank and the independent Treasury, the one representing the financial resources of fifteen thousand independent banking constituencies, the other representing the combined resources of the nation.

CURRENCY REFORM

ADDRESS DELIVERED BY LESLIE M. SHAW, SECRETARY OF THE TREASURY, BEFORE THE OHIO BANKERS' ASSOCIATION, AT CLEVELAND, SEPTEMBER 28, 1905.

THE fact, and I think it is a fact, that the United States has the best currency system in the world, does not imply that the currency system of the United States is perfect or that it cannot be improved. It is as safe as any system in the world because it is established on the only safe basis known to man—the gold standard. It is not

safe simply because the dollar contains 100 cents. If we were on a silver basis, the dollar would still contain 100 cents, but they would be silver cents. The United States dollar is worth not only 100 cents, but 100 gold cents. The dollar is worth 25.8 grains of gold. That measures the market value of our dollar. Whatever 25.8 grains of gold will buy our dollar will buy, and it is worth precisely the same uncoined as coined, for the government stands ready to coin it free and in unlimited quantities.

Then, in addition, every dollar of our currency—gold certificates, silver, silver certificates, United States notes, treasury notes, national-bank notes, subsidiary silver, nickel and copper coins—is redeemable in or exchangeable for gold at the will of the holder. This fixes the stability of our currency. Its value does not and cannot fluctuate. I grant that there is no express statute for the exchange of gold for silver certificates or for silver itself. Silver certificates are, of course, redeemable in silver. Silver certificates are simply warehouse receipts for the number of silver dollars mentioned in the receipt, and on the return thereof the coin can be demanded. But the law expressly provides that the Secretary of the Treasury shall maintain the parity of all forms of money coined or issued by the government. The only way to make a silver dollar, the metallic value of which is but 50 cents, worth 100 cents in gold, is to give gold in exchange for the silver whensoever and by whomsoever demanded. On this proposition the record has been made so that subsequent Secretaries of the Treasury for all time, whoever they may be and whatsoever party they may represent, will find it necessary to overrule the decision of at least one predecessor before they can refuse gold in exchange for silver; and until such refusal silver will remain at par. There being but one way to preserve parity in time of pressure, the best way to avoid a time of pressure is to make public the government's intention to redeem in gold at all times. Thus all forms of lawful money are exchangeable for gold, and national-bank notes are redeemable in lawful money. These provisions make our system absolutely safe, and no man need look the second time at any form of our circulating medium to discover its actual or exchangeable value.

It is the most convenient system in the world, because it is con-

structed on the decimal or metric system. It is not necessary to carry a lightning calculator in order to make change.

The system is not perfect largely because it is non-elastic. It fails to respond in volume to the changing needs of seasons and of localities. Attention has been called to this many times and by many people. That there will be no further currency legislation until we shall have experienced a panic occasioned by this want of elasticity, I am convinced. The country does not appreciate the danger, and until the danger is fully understood no remedy will be applied. We came nearer such a panic September 30, 1902, than most people appreciate. The fact that we then escaped does not raise a presumption that we shall always escape. A glaring defect at a vital point will sometime, soon or late, assert itself. Meantime a remedy should be discovered, discussed, and as far as possible agreed upon, so that it may be promptly applied when the people are ready for it.

Let me define this defect more specifically. Annually we have an excess of money during the spring and summer months. Annually we pass through a period of anxiety as we approach the period of crop-moving, for annually the volume of money is relatively insufficient to meet this sudden increase of business. We do not need and must not have inflation. The average amount of money is, in my judgment, abundant. The difficulty lies in the fact that the volume remains stationary. The result is as unsatisfactory as it would be for railroads to run the same number of freight trains with the same number of cars on the same schedule of time at all seasons of the year—rumbling along empty in June and overloaded in October. If such a policy were pursued by railroads, the unnecessary cars would naturally invite loads of straw and chaff and worthless plunder; and when the time came to use the cars in legitimate business, much disturbance would ensue while they were being unloaded and fitted for profitable employment. Similar conditions occur annually in our currency system. Cheap money during summer months, like cheap cars, invites anything and everything except legitimate business; and when the money is needed in the fall, like the cars, it is occupied, and much disturbance to commerce is occasioned by the unloading. In the language of the street this unloading is called liquidation.

Let me use another illustration. You bankers were nearly all reared on a farm, and most of you have led a horse behind a buggy. Those of you who have performed this task have doubtless noticed that when you let the horse out the full length of the halter, be that halter long or short, you have experienced some inconvenience whenever you passed rapidly over rough places, and you have sometimes felt the knot at the end of the strap. Thus by experience you have found it convenient to keep some slack to be let out as occasion requires. We employ every inch of our financial tether all the time, and some fine day the unexpected will cause another acute tension and we shall again feel the knot. Fortunate indeed we shall be if it does not slip through our hand.

Now, what shall be the remedy? Shall it be asset currency? In the popular acceptation of that term, I answer "No!" Asset currency, as commonly understood, would mean inflation, and that we must not have. Asset currency, as commonly understood, would be supported only by the solvency of the bank of issue. That must not be. No currency must be issued under any circumstances that will cause the holder to look twice at it to discover its exchangeability for gold. Shall it be emergency currency? In the popular acceptation of that term, I answer "No!" The United States originates more commerce than any other country on the map, but our chief commercial city is not the world's clearing-house. It ought to be, but it is not. One reason why it is not is the fact that it has sometimes resorted to clearing-house certificates, which is a plea of guilty to an indictment charging bad management locally or bad legislation nationally; and the financial world charges both. Clearing-house certificates must never be authorized by law. Let those who love our country and those who conserve her credit set their faces against such a course with the same intensity as that with which they resist the free and unlimited coinage of silver. Clearing-house certificates debase our currency with the consent of those who are supposed to be the best financiers in the nation. The free coinage of silver would debase it through political upheaval. The threat of both, I doubt not, contributes to that distrust which prevents foreign bankers from keeping their international balances in America. Whatever the remedy shall be, it must not advertise our calamity or our extremity.

Among the many remedies suggested, none appeal to me as strongly as the authorization of additional national-bank circulation. This method involves the right of national banks to increase their circulation in an amount perhaps equal to 50 per cent. of their outstanding volume of government-bond-secured circulation, on which the bank should pay a tax of 5 or 6 per cent. during the time it is maintained, and the government in consideration of this tax, should guarantee its redemption.

I indorsed this plan not long ago in the second largest city of this nation. The next morning one of the daily papers had interviews from several bankers to the effect that they would not issue currency, under ordinary circumstances, if taxed at 5 per cent. This confirmed my belief that the proposition was wise. It certainly would not result in inflation. Though the right to issue additional circulation were granted, I should be exceedingly glad if it were not exercised for many years. It would demonstrate that we had passed over no very rough places.

You may call this, if you please, an emergency provision. So it is; but it injects into our circulation no new form of money as an element of alarm. By eliminating the one statement on the present bank-note, "This note is secured by bonds of the United States," the additional currency could be made identical with that based on government bonds. The Comptroller of the Currency and the bank issuing the currency would alone know of its existence. It would not advertise its existence or our extremity, and I can scarcely conceive of conditions under which it would remain out sixty days. It could be printed and kept ready for issue as occasion might require, and it would be retired, not by gathering up each individual bill, but by a deposit of an equal volume of money with any sub-treasury. Then the notes as they came in would be charged against this deposit until it was exhausted, after which redemption and reissue would run on as before.

CURRENCY REFORM

ADDRESS DELIVERED BY JOHN L. HAMILTON, EX-PRESIDENT OF THE AMERICAN BANKERS' ASSOCIATION, BEFORE THE MICHIGAN BANKERS' ASSOCIATION AT GRAND RAPIDS, JUNE, 1906.

THE American Bankers' Association has a federal legislative committee which has taken up and is preparing a plan[1] of currency reform, which we believe will be beneficial to every banker in the United States and in fact to all the citizens of the United States. That committee was one appointed pursuant to a resolution adopted at the last convention at Washington, and by virtue of the resolution I happen as president of the association to be a member of the committee.

The plan provided is this: that a currency commission of seven members shall be appointed by the President of the United States and confirmed by the Senate; the Comptroller of the Currency to be a member of that commission and the other six members to be appointed upon the first commission as follows: two for four years, two for eight years, and two for twelve years thereafter; the commission to be non-partisan, selected from the different sections of the United States. The object in fixing the length of service is this, that an incoming President would have the naming of only two members of the commission, thereby having four members of the commission that would hold over. Hence if by any accident a man who was not desirable, not a safe financial man, should be elected President, he would not disturb the financial conditions of this country. In the minds of the public to-day there is a sentiment that all financial institutions or any other institution of great importance should be under more direct federal control, and that is another reason for the selection of this commission.

It is proposed that national banks be permitted to increase their circulation, in times of emergency or in times of necessity, to an amount equal to 50 per cent. of the bond-secured circulation of the national banks outstanding. The object in basing it upon its bond-secured circulation is this: it was the original intent of the government, when the National Banking Act was formed, to provide a market for the government's securities; that idea still prevails in the minds of the public, and so far as I am personally concerned I believe it is the proper basis on which to base our circulation. If

[1]This plan was presented to the Association at its annual convention in St. Louis, October, 1906.

you base this emergency circulation upon the bond-secured circulation, then there will be a tendency to increase the circulation of the national banks. If national banks are permitted to issue an emergency currency based upon their capital or surplus, then there will be a tendency to decrease the bond-secured circulation and to depend upon the emergency circulation,—a condition which you would not want.

We all know that there is not a real necessity for more circulation to-day, but there is a necessity for more confidence; it is the lack of confidence and the fear of an emergency that cause the withdrawal of funds and the hoarding of them away during the fall of the year, the crop-moving period. If this condition did not exist, if this feeling of uncertainty did not exist, then there would not be any occasion for an emergency circulation. However, if it is known to the people of this country that an emergency circulation can be issued, then the necessity for that will largely be eliminated, and the natural increase of bond-secured circulation which naturally would be taken out, will in a measure eliminate the necessity for an emergency circulation.

The theory has been advanced by Mr. Fowler and by several men prominent in financial circles, that an emergency circulation should be based upon the rule of supply and demand. Human nature is the same everywhere, with bankers and with the individual, and if a banker can issue at will an emergency circulation or a credit currency—call it what you will—the tendency is for him to issue that currency and keep it out as long as possible. Under the plan that we propose, if a bank wishes to issue an emergency circulation, it must apply to this commission, stating the necessity for it, and the commission will determine whether such a circulation should exist or not and will fix the time for which the circulation shall remain outstanding. If the time fixed by the commission, for instance, is three or four months, then the bank shall pay a tax at the rate of 1 per cent. per annum for this emergency circulation for the time it is outstanding. In order to retire this circulation it is proposed that an additional tax of 1 per cent. each week shall be charged for every week after the time fixed for the redemption has expired.

Here comes another difficulty that may appear to many of you, and that is this, that if the First National of Grand Rapids or any

other city should issue an emergency circulation and the time were fixed at three or four months for its retirement, a rival concern, a state bank or private bank or savings institution, might hoard up the bills of that institution until the time fixed for redemption had expired and then present those bills, which would be a detriment to the bank issuing them. It is proposed by this commission that these bills shall be issued by the Treasury Department at Washington, and nothing upon the bill shall indicate the name of the institution issuing it, so that in the event that a bill or a number of bills of an institution should remain outstanding for a longer period than the time fixed for the redemption, the bank issuing it will not be discredited by the bill's being out.

It is proposed that this currency be secured by the placing of the ordinary securities of the bank with this commission or with the Comptroller's department, such securities to be passed upon by the Comptroller's department, in an amount 10 per cent. in excess of the amount to be issued. The banking institutions of the United States are the only commercial institutions that have any means of expanding their credit; they are the only institutions as a whole that have no means of protecting themselves by using their credit; and it is the purpose of this commission to give to the banks this kind of protection by the depositing of their securities temporarily and the issuing of these bills, so as to tide them over any emergency that might temporarily arise. It is the purpose of this committee that these bills shall be retired by the depositing of sufficient funds either with the sub-treasury or depositaries designated by the commission for their redemption.

The result will be this: that this emergency circulation when once issued will, a certain per cent. of it, remain out for a considerable length of time, giving an additional amount of money in circulation. These bills in the hands of the public will be absolutely secure, for the reason that the bank either has deposited the securities to protect the bill or has deposited the actual cash for their redemption with the Treasury department of the United States; and in the minds of the public that naturally will be one of the best bills in circulation.

Another objection that has arisen in the minds of some is that the moment such a bill becomes a law the price of government bonds

will go sailing up so high that there will be no possibility of the banks' purchasing them and using them for a means of increasing their bond-secured circulation. This feature is a protection—the proposed plan—for the reason that if the price of bonds did not go up you would have an abnormal inflation of circulation, which would be a condition of affairs that you would not want. However, if there should come a panic upon the people at the present time, you would want a means, under our present circulation, of increasing the emergency circulation 250 millions of dollars and upwards, —a sum sufficient to meet any condition that might arise.

Going further, it is proposed that any bank may make application for this kind of circulation at any time; or, in centers where there is a clearing house, or in commercial centers like New York, Detroit, Chicago, and such places, that where a majority of the national banks of those cities make application to the commission for this kind of security it may be issued. In other words, you place one commercial center independent of any other commercial center as to the issuing of this particular class of circulation, enabling them to meet conditions that may arise within their particular community, and are only temporary.

The federal legislative committee has been before Congress two or three times during the last session, and we have learned there that if the bankers of America hope to secure legislation beneficial to their interests, such legislation must have the endorsement of the bankers' association of America or we cannot hope to secure it.[1]

There is a movement in some sections of the country for real estate loans as a part of the assets of national banks. There were two or three bills to this effect introduced at the last session of Congress. And it is the purpose of our committee to prepare and to submit to the association a separate measure along this line, leaving it to the wisdom of the convention as to the advisability of adopting or rejecting such a measure.

[1]At the time this plan was presented to the American Bankers' Association in St. Louis, the objections made were such as to cause much dissatisfaction. The result being that this committee was enlarged by adding several new members, and in conjunction with the New York Chamber of Commerce Committee, met in Washington, D. C., in November. The conclusions arrived at by this joint commission are embodied in a report published in *The Financier*, November 19, 1906.—EDITOR.

There has also been suggested the advisability of giving trust features to the national banks similar to those enjoyed by some of the trust companies of the United States. This will also be submitted, and the bankers will have an opportunity to decide whether or not they care to adopt such measure.

In addition it is expected that the different committees will have prepared their reports, and will submit the different bills that are now being prepared and are to be submitted to Congress, upon the various questions of interest to the bankers of the United States.

THE MONETARY SITUATION AND ITS REMEDIES

ADDRESS DELIVERED BY HENRY CLEWS, OF NEW YORK, BEFORE THE WEST VIRGINIA BANKERS' ASSOCIATION, AT ELKINS, JUNE, 1906.

How far the Chamber of Commerce[1] on the reform of the currency will succeed in providing remedies for the monetary situation remains to be seen. But from the twenty-seven questions it has sent to bankers and others, it is apparent that it contemplates no fundamental change in our currency system. Inferentially, it will not interfere with United States legal tender notes, nor with United States bonds, as a basis for the circulation of the national banks. Yet both bases are indefensible on sound economic principles. The issue of greenbacks was merely a war measure, and intended to serve only a temporary purpose; instead of which we have made it permanent, thus keeping the government in the banking business with its war currency system.

There can be no question as to the false bottom on which the national bank currency rests; for paper, that is paper money, should not be secured by, or redeemed in paper, even when that paper is as indisputably good as United States bonds. All our paper money

[1]This address was delivered during the time the Chamber of Commerce Committee was working on its report which was made public October 4, 1906. The report was published in part in the *American Banker*, October 6, 1906.

ought to be based on readily convertible assets and redeemable in gold. Bonds, even United States bonds, by which national bank notes are now secured, are only evidences of debt, and the time will come when these will be liquidated—the sooner the better.

The committee probably thinks that the existing order of things, notwithstanding its fundamental errors, is too deeply rooted and strongly fortified, to be materially changed without danger that the remedy will prove worse than the disease. It consequently favors more national bank currency on the present basis. Branch banks and rediscounting for small banks by large banks are also favored. The committee's questions indicate, however, that it favors the abolition of the sub-treasury system, and to that result it should resolutely bend its energies. At present, the sub-treasuries are practically banks, like the old United States bank at Philadelphia, with the important difference against them that all the money they take in remains locked up in their vaults till paid out on treasury drafts. The evil effect on the money market, and particularly on Wall street, of thus withholding money from circulation in periods of stringency, has been too often felt. It was more than usually conspicuous and severe during the late tight money ordeal, because the treasury receipts very largely exceeded its disbursements. This greatly aggravated the scarcity of money in New York due to other causes, and the result in Wall street was that the rates for call loans ranged at times within the last six months, with rapid and eccentric fluctuations, from 15 to 30 per cent. and on one occasion touched 125 per cent. We have here a phenomenon entirely distinct from ordinary monetary conditions.

However much our commanding positions may, in other respects, fit New York to be the world's financial center, it cannot aspire to and secure that position of power, so long as it is the scene of these violent fluctuations in the rates of interest for call loans on the stock exchange. Measures should therefore be taken, not only to prevent them, but to make their recurrence impossible; and how this can be best and most efficiently accomplished is a matter for very serious consideration.

That it can be accomplished is evident from the entire absence of any such violent rate oscillations in the money markets of Europe. There, the rates of interest fluctuate slowly within a reasonably

narrow range, generally between 3 and 5 per cent., the extremes being 1 or 2 above, or below, these figures. Such unreasonable eruptions in the money market as we have sometimes seen in the loan crowd of the New York Stock Exchange, were never seen and would be impossible in London, Paris, Berlin, or any other European capital. Why, then, should they ever occur or be possible here?

In response to questions by the Chamber of Commerce committee, I would say that, as the sub-treasury system is a disturbing factor in the money market, provision should be made by Congress for the regular deposit in national banks of surplus government money above its regular working balance of fifty millions, the banks to pay interest at 2 per cent. per annum thereon.

Bank notes, in my opinion, are a form of bank obligation the same in principle as bank deposits payable on demand; and these notes, as the most convenient form of credit, should be released as much as possible from restrictions not necessary to secure their safety, acceptability, and redemption in gold, or United States legal tender notes, for so long as the latter may be kept outstanding.

In seeking increased flexibility for our currency, I would not suggest anything that would impair the value of United States bonds as a basis of circulation; but it deserves consideration whether new currency might not be issued by moderately increasing, above the par of the bonds but not above their average market value, the amount of notes to be secured by them. Then, too, why should not national banks be authorized to issue a fixed proportion of circulating notes upon their general resources, these to be secured by a guaranty fund? To induce the retirement of these notes when not needed, because money is superabundant at low rates, this asset circulation could be made liable to a graduated tax. The proportion of notes to capital that should be allowed, and the amount of the tax, are matters upon which bankers differ, but I favor strict moderation in both. This asset currency, under moderate restrictions, for use under ordinary conditions, would be far preferable to any emergency circulation, issued under a high tax, although Secretary Shaw recommended the latter in his report for 1905.

As the taxes collected upon circulation of national banks from 1864 to the end of June, 1905, amounted to $90,220,997, and the

failed banks, during that period, had outstanding only $17,295,748, of notes, and the dividends paid on their claims averaged 77.95 per cent., it follows, at the same rateable proportion of loss, that the deficiency on account of their notes would have been only $3,813,-712, or 22.05 per cent. of their total circulation. So in the light of this experience I see no great risk in a guaranty fund, consisting of the taxes paid upon circulation, nor do I see why it would not be sufficient to redeem all the notes of failed banks.

I would make the asset currency a first lien upon the assets of the issuing banks, and allow the banks to redeem their notes at appointed redemption places in the large cities. This would save the trouble and delay of sending them to Washington, and by facilitating redemptions when money was easy, would give more ebb and flow to the currency and tend to prevent excessive speculation in times when there is a glut of money. Under the Canadian banking system, there are several central redemption cities for bank notes; but I would not, as is the case in Canada, limit the right to issue notes to banks of not less capital than $500,000. There is safety in numbers, in regard to banks as well as other matters. Then, too, it would be well to make all the sub-treasuries in the country useful as national bank note redemption points, because this would contribute to the elasticity of the currency in the same way that it does in Canada, and doubtless Congress would favor such a measure.

The proposition to establish a new bank in Wall street with $50,000,000, or even more, capital, or to increase the capital of an existing bank to that extent, to serve the purposes of stock exchange borrowers, and regulate rates of interest, after the manner of the Bank of England, is deserving of no consideration whatever. It would merely excite and provoke the jealousy and opposition of other banking institutions, and create a sort of monopoly with special privileges, without securing the end in view. A bank of banks is not what we want, nor do we want a revival of the old United States bank. Such a bank as the Bank of England, or the Bank of France, could not be created here, either in a day or a generation, for those time-honored institutions are the growth of ages They are very much older than any of the other banks there; and, under the control of their respective governments, they have

grown up with their countries and become practically, although not by ownership, government institutions. Hence their prestige and power, and the impossibility of other banks' superseding them.

It may, however, deserve consideration whether the New York Clearing House might not exert power in regulating rates of interest similar to that exercised by the Bank of England, provided the banks belonging to it would unite to give it that power; and is there any reason why they should not? Even without any formal or concentrated action in this direction, outside of the Clearing House committee, it could appoint a committee to name every week, or oftener when necessary, as the Bank of England does, a minimum rate of interest on call loans and discounts. It could also fix a maximum rate for each. This need not be compulsory; but even as a recommendation only, it would have a powerful moral effect, and the Wall street banks, if they approved of the innovation, would conform to it. The Clearing House could, indeed, after the formal approval of this regulation by its members, enforce its observance under penalties, if deemed necessary. In this alone, in my opinion, a practical remedy would be found for the high rate evil on the stock exchange.

But at the same time, greater elasticity could be given to our national bank currency if Congress would amend the law so as to permit the issue of currency against specified bank assets, subject to the approval of the Comptroller of the Currency. This is a feature of the banking system of other countries, which has always worked very well and to the satisfaction of all interests; and what our currency urgently needs is greater elasticity.

Strictly speaking, according to economic principles, we cannot expect perfect currency, with all the resiliency and elasticity possible in a currency, so long as bonds, instead of gold, are used as the basis of our bank circulation. Yet for security the bonds are, under present conditions, just as good as gold; and there would be more elasticity in the bank circulation based upon them if the restrictions imposed upon their redemption by the act of 1882, which are now unnecessary, were removed. Indeed, the inability to retire bank notes promptly is one of the worst faults of our system, and Congress should repeal the restrictions without delay. If this obstacle in the way of resiliency were removed, and the un-

limited retirement of bank notes permitted, we may rest assured that free expansion, when demanded, would quickly follow curtailment, and this ebb and flow of the currency would obviously be an elastic movement.

As it is, there is a great waste of banking power in our treatment of national bank notes and reserves. We have $544,765,959 of national bank notes, and only $337,130,321 of United States legal tender notes, and, setting gold aside, the redemption of the former in the latter is obviously absurd and inconsistent with sound finance and good banking. We see in the present system, this $544,765,959 of banking capital absorbed and represented by non-reserve currency. The capital is perfectly safe, but it is locked out of any other use, and rendered inefficient for any other purpose. This calls for a remedy. The percentage of reserve to loans in national banks has decreased from more than 20 per cent. in 1898, to less than 15 per cent. Hence the bank reserves require to be increased. The law relating to the redemption of national bank notes in United States notes, or greenbacks, was passed when the greenbacks very largely exceeded the bank notes in amount; but the reversal of these conditions reminds us that the tail is now wagging the dog. This alone makes it clear that the law should be amended.

But beyond all this, we should open our money market more to the rest of the world by establishing a new factor, which would always afford prompt relief in times of stringency, by giving us cable transfers of gold, instead of gold shipments, and of itself prevent abnormally high rates. Through this medium we could instantly draw gold from Europe whenever it is wanted, and Europe could do the same from us, when it is needed there. I refer to the establishment of an international gold transfer system, or clearing house, to supersede and dispense with what I may call the old-fashioned gold see-saw. Gold in circulation is doing good work, but gold see-sawing across the ocean is going to waste. The custom of shipping gold from one country to another, in response to the ups and downs of the market rates for foreign exchange, not only reminds me of forward-and-back movement in a quadrille, but suggests that, as the precious metal is rendered practically useless while in transit, it should not be used in a dance of that kind across

the ocean. The subject may not seem to be very important, but it really is so, for "tall oaks from little acorns grow"; and it is surprising that in the march of modern improvement this method of settling international balances has not been superseded by a shorter, quicker, and cheaper cut to transatlantic adjustments. Bankers in both hemispheres are absurdly behind this progressive and electric age, in transporting gold from the new world to the old, and vice versa, to adjust balances between them, whenever the rates of exchange show a profit in the transaction. That they could profitably dispense with it is obvious, as they could easily establish this transfer system, this international clearing house for gold, at very small expense. Thus the risk and loss of time involved in the old-fashioned method would be eliminated, while the new arrangement, being under their own control, would beyond peradventure serve every necessary purpose of the shippers, besides assuring perfect safety.

All these disadvantages could be obviated and this handicap upon our commerce removed by a mutual-interest arrangement between the leading banks in the United States and Europe, to deposit a sufficiently large amount of gold on each side of the Atlantic, and issue international clearing house certificates and draw bills of exchange against the deposits. This gold would be counted as part of their reserve, if in their own vaults; or the Bank of England in London, and the United States sub-treasury in Wall street, could be used as the gold depositories. We have a clearing house for bank checks in each of the large cities, and one also for the transactions of the New York Stock Exchange. London, too, has its bank clearing house. Why, then, should the clearing house system not be extended to international transfers of gold, so as to make them possible at any moment by cable-telegraph instead of the slow process of six day's transfers? In this way our international dealings would be quickened and extend our financial and commercial relations become more intimate. There is no good reason why we should unnecessarily treat gold as we do, when we can save time, money, and risk by keeping the metal where it is and issuing certificates of deposit against it, the use and transfer of which would serve as well as gold shipments.

The present custom becomes a ridiculous chase across the At-

lantic, when we see the same gold shipped to Europe, then shipped back to America within a few days after reaching its destination, without being unpacked, because sudden intervening changes in the rates of exchange make it profitable for the former gold exporting country to import the metal. Such wasteful shilly-shally procedure would be likely to excite mirth in opera bouffe; but bankers who ship gold are very serious about it, and seem to be without enough perception of the ludicrous to see anything funny in its coming and going, although they feel the shoe pinch in its costliness in both time and money. As the world's gold production increases, the urgent need of this over-sea change will become more and more conspicuous and its adoption will accord with the generally progressive spirit and methods of our telegraphic and telephonic age.

Had such an international gold clearing house existed, the sagacious but unprecedented action of the Secretary of the Treasury, to relieve the money market by making deposits, as secured loans, in certain banks, to encourage and cover their prospective gold importation from Europe, the same to be returned on the arrival of the gold, would have been unnecessary. While this expedient has well served a temporary purpose, it is not to be relied upon as a permanent source of relief during monetary stress, and it involves a stretch of authority under the law that is open to grave objection. But, as it happened, the Secretary's action, which was taken just before the San Francisco disaster occurred, proved particularly fortunate, and probably prevented a very serious aggravation of the stringency in the money market, owing to the heavy remittances to California. It was a piece of good luck that seemed almost providential, and the end justified the means. But it should always be regarded as only a fortuitous circumstance and a temporary expedient, not as a permanent source of relief; and it emphasizes our need of a new international gold transfer system. Moreover, the benefit Europe would derive from it would be equal to our own.

The Secretary, under the circumstances, acted wisely in also increasing the treasury deposits in the national banks while the government's receipts were largely in excess of its disbursements, so as to offset, as far as possible, this preponderance of receipts,

and lessen the drain of money into the sub-treasuries. But this method of relief is, too, only a temporary expedient, to remedy the evils of the sub-treasury system. While the sub-treasury system lasts, Congress should authorize the Secretary to deposit customs, as well as internal revenue receipts, in the national bank depositories, in times of stringency, when the government's receipts exceed its disbursements and it has more than a sufficient working balance. The government should, as a compensation to it, require the banks to pay interest at, say, 2½ or 3 per cent. per annum on such deposits, these not to exceed in amount 25 per cent. of their paid-up and unimpaired capital, and to be returnable on demand, but without requiring these special deposits to be secured. They should, however, be made a first lien upon the assets of the banks.

If the changes above suggested were made, I am sanguine that they would prove to be remedies for the evils and disadvantages under which we now labor, and thus increase the stability of our money market, and improve and fortify the machinery of the whole monetary system, while giving more elasticity to the currency.

PENDING FINANCIAL LEGISLATION

ADDRESS DELIVERED BY CHARLES N. FOWLER, CHAIRMAN OF THE COMMITTEE ON BANKING AND CURRENCY IN THE HOUSE OF REPRESENTATIVES, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT ST. LOUIS, OCTOBER, 1906.

YOU will pardon me one or two personal experiences; since they furnish whatever of confidence and assurance I have that in the end the wisest thing will be done, even though it may come as the result of bitter trials and frightful losses.

When Representative E. J. Hill came to Washington in 1894, we were both appointed to the Banking and Currency Committee, and he was at once my most assiduous and powerful opponent. But his absolute intellectual honesty, his great ability, his determination to know the truth, made him a thorough and reliable student. Coming from the Connecticut State Convention, in the spring of 1896, he showed me a resolution passed there to the effect that the

Republicans of Connecticut were utterly opposed to any kind of currency except such as was secured by government bonds.

He asked me what I thought of it.

I replied that it only marked a degree of ignorance, not of intelligence.

Six months later, he told me that he was ready for at least fifty per cent. of credit currency.

I replied that if he took six months for study and reflection he would be ready for another fifty per cent of credit currency.

Again, Hon. Lyman J. Gage told me soon after he came to Washington that he knew absolutely nothing about the subject; but his years of study brought him to the same conclusion.

Only a few days ago, while sitting at luncheon with the officers of one of the great banks of New York, I remarked that I had never known a man who had made a study of credit currency with an open mind, who did not come out exactly at this same point. One of the officers, himself a great student and an acknowledged leading financier, replied, "That is literally true."

Cleanliness is next to godliness; therefore, let us fight to make our money as clean as it is good. And let me say right here that you will get nothing in the way of legislation unless you—I mean you men who are sitting before me, you bankers, as bankers, not merely as men—interest yourselves in demanding that your representatives vote for the things you want. Let us understand this once for all; and, as we proceed to discuss the pending legislation and agree upon certain principles, let it become a part of your daily life, a duty of every hour, to secure their adoption. Otherwise, if you make them only one of a hundred recollections, it were as well that we had never come here.

First, then, let us here and now resolve that we will have clean money; and pledge ourselves to one another that we will not stop until we have secured such legislation as will bring this end about. Such a law is now pending before the Banking and Currency Committee. It will become a law, if you demand it and work for it.

A bill has been favorably reported by the Banking and Currency Committee, and is now pending before the House of Representatives, providing for the issuance of $5 and $10 gold certificates, as well as the present denominations. The purpose of this bill is

twofold. First, it would enable the Secretary of the Treasury to supplant a portion of the $300,000,000 of five-dollar silver certificates with gold certificates of the same denomination, and thus make it possible to increase largely the one and two-dollar silver certificates, which are so much needed in the trade of the country. Of this you are more fully aware than any other class. Will you pledge yourselves here and now to fight for this change; or go on forever as at present with the demand for small notes constantly increasing because of additional population and doubling trade, but with nothing out of which to make them?

The second object of this measure is to broaden the basis of the standard of value, increase the quantity of gold in the country, and make it possible to distribute it among the mass of people, thereby generalizing its use, as well as strengthening our reserves. These objects justify your active and insistent co-operation.

From the establishment of the first sub-treasury, sixty years ago, the practice of hoarding or locking up money has been a disturbing factor and a curse to business. Now, jumping over all the past, and taking up the situation precisely as it presents itself to-day, what shall we do; go on as before, or like intelligent men treat this Government's business just as you would treat it were it your own, making only such distinctions as a due regard for the people's interests, from a national point of view, demands?

The fiscal operations of our Government are such that, the coming year, we may have a surplus of fifty or possibly seventy-five millions. Indeed, we may again have the same excess of revenue we had from 1888 to 1892, when we lowered our bonded debt from $1,021,000,000 to $585,000,000, a decrease of $435,000,000. What shall be the conduct of the Treasury? Should it not be such as in no way to interfere with the commercial interests?

If we should repeat this record, we could pay off $435,000,000 of our debt, and leave it at $490,000,000, or $25,000,000 less than the amount now deposited to secure our bank-notes, which aggregate $517,000,000. If our excess should not be applied to the reduction of our debt, it would have to be deposited from time to time in our national banks, and the banking capital of the country would be reduced by the cost of the bonds required to secure such deposits. Our banking capital is now depleted more than $150,000,000 by this

ancient and inane procedure; and, though the Government has control of this money, it is paying two per cent. upon it; for the interest paid on the bonds held by the Government goes to the banks that have put up the bonds to secure the deposits.

The available cash balance, July 1, 1906, was $222,000,000. In other words, at the very season of the year when there was a constantly growing need of money, and panic prices for its use, the Government has been engaged in withdrawing it from the channels of trade at the rate of $15,000,000 every month, or $47,000,000 for the months of July, August, and September. It may be asked whether the Secretary of the Treasury has not redeposited the money so withdrawn. Yes; but only on condition that the banks would purchase and put up specified bonds amounting to more than $50,000,000; so that the banking capital of the country has been depleted during these three months by that amount. As a result, credits have been displaced, business seriously disturbed, and no good whatever has come to counterbalance the loss and havoc. Why should not the Government do just what you are doing: deposit its money with national banks and get two per cent. on its daily balances?

On September 4, 1906, the National banks had on deposit with national banks over $830,000,000, or seven times as much as the Government had; and were undoubtedly getting 2 per cent. interest upon it. The state banks and bankers had on deposit with the national banks more than $381,000,000, and were undoubtedly getting 2 per cent. interest upon it. The trust companies and savings banks had on deposit with the national banks upwards of $346,000,000, and were undoubtedly getting their 2 per cent. interest. In other words, the banking institutions of the country had on deposit with our national banks more than $1,500,000,000, or more than ten times as much as the Government had; and yet the Government by its practices would have us believe that although it has the power of supervising and knowing all about the management of every national bank in the country, it cannot safely do what probably every banking institution in the country is doing without any special information at all.

Let the Government deposit its receipts from day to day precisely as our municipalities and great business interests do. If it

had pursued this policy from 1879 down to the present time, and received, as it had the right to do, two per cent. interest upon its balances, it would have received $50,000,000 in interest, and not have lost a single dollar.

A bill has been favorably reported by the Banking and Currency Committee and is now pending before the House of Representatives, providing for the daily current deposit of all public moneys. It will depend upon your active co-operation whether the Government shall do its business as the bankers of the twentieth century do theirs, or whether it shall continue to do it as General Jackson, inspired by passion, in his supreme ignorance began to do it nearly a century ago.

During the present crop-moving period, there will be taken from the vaults of the country approximately $200,000,000 of United States notes, gold certificates, silver certificates, and other forms of lawful or reserve money, and sent into those parts of the country where checks are not used for the purposes to which this will be put. For the sake of being definite and comprehending fully the effect of this movement of reserve money from the banks to the country, let us assume that when the movement began the banks had loans outstanding up to the limit provided by law. What effect would this movement have upon the credits of the country?

The Actuary of the United States Treasury prepared for me a table showing that the credits which would grow out of deposits of $100,000, made respectively in a central reserve city bank, a reserve city bank, and in a country bank, would reach an aggregate of $1,906,000. This is, the credit standing upon $300,000, deposited as stated, would be six and one-third times that amount; while the total credits of the reserve city banks would be exactly $1,000,000, or five times the $200,000 deposited with them.

It will be reasonable, therefore, to assume that, if $200,000,000 of money in actual use as reserves is taken out of the bank vaults and scattered over the wheat, cotton, and corn districts to assist in moving the crops, credits to the extent of at least five times $200,000,000, or $1,000,000,000, are disturbed and displaced. With the Treasury concurrently withdrawing $50,000,000, or more, from the channels of trade, and our credits contracting to an extent approxi-

mating $1,000,000,000, does anyone wonder that money runs up to 125 per cent., when the straining and breaking contraction is on?

Need anyone wonder, when the flood of money returns to the centers, the wheat, the cotton, the corn, the cattle and the hogs, the products of about one-half of our entire population, having been marketed, and there is no further immediate need of these tools of commerce in the country districts, that money, so-called, but nothing but credit based upon these reserves, can be had for one per cent.? Need anyone wonder that speculation runs riot, and that we have an abnormal money condition all the year around? Now too much; now too little; and never anything like a natural relation between capital and business—all this because we do not recognize one simple truth about credit, and put it into operation. What is this simple truth? It is this: that there is not the slightest difference in essence between the true bank-note and a bank check.

The committee, appointed by the New York Chamber of Commerce, composed of some of the best scholars in the United States, used the following language in its report, just published:

"Between a bank-note and a bank check there is no essential difference. The depositor, to be sure, is a voluntary creditor of a bank, and the checks written by him do not circulate widely without endorsement, whereas a bank-note is an acceptable substitute for money among people who have little or no knowledge of the issuing bank. Nevertheless both the check and the note are representatives of money, and both must be redeemed on presentation. They have, however, different fields of usefulness. The home of the bank check is the town and the city, where people keep their funds in banks. The bank-note, on the other hand, belongs in the country among people who have no bank accounts, with whom it is quite as effective as money itself. If our banks were permitted during the crop-moving season to increase their issues of bank-notes by from $100,000,000 to $200,000,000, these notes would go into the harvest fields and do the work which now absorbs legal tender money. Since the banks under such circumstances would not be obliged to pay out lawful money from their reserves, they would be under no compulsion to contract their loans as at present."

Hon. Lyman J. Gage recently used this language:

"There is no difference in principle between the obligation of

the bank, expressed by a credit on its books, and its note which may pass from hand to hand. The public is the best judge, according to time, place, and circumstances of what will best serve its needs, whether bank-notes or credit on bank books; and the greatest freedom of choice, consistent with safety, should be allowed. In France, the people hold claims against the Bank of France to a total of $1,045,000,000. Of these claims $944,000,000 were evidenced by the notes of the bank and only $145,000,000 by credit entries (deposits). In Germany the Imperial Bank owes the people $330,000,000, evidenced by notes and $125,000,000 in so-called deposits. Quite in contrast with the countries named stands Canada. The banks in Canada owe the people eight or nine-fold, by book account, what they owe them as evidenced by circulation notes. It is to be observed, however, that in all these countries the relation between the two is constantly changing according to the desire and convenience of the people. By an easy process 'deposits' are converted into 'circulating notes' and 'circulating notes' are convertible into 'deposits.' They are, in their nature, reciprocal; the conditions that surround them are essentially alike, and the relative volume of each is governed, not by the will of the banks, but by the needs and convenience of the people."

How can we apply this principle to our own conditions? It has been observed that during the crop-moving period, this year, from July 1st, there will have to be sent into our great agricultural sections $200,000,000 of currency or money for the purpose of moving the crops. Let us assume that this amount is due from the banks in the money centers to the banks located in the crop-growing territory; and that on the first day of July the demands for this amount were met in the denominations asked for by cashiers' checks drawn to bearer. What would the result be?

All the country banks would be paid off in full; but the city banks would have a corresponding liability to meet in the form of cashiers' checks or credit bank notes, for the two are identical. What has actually taken place? Bank book credits have been converted into bank-note credits to the extent of $200,000,000. The bank credits of the country have not been increased by a single dollar. There has been neither expansion nor contraction. It has been a simple transaction in bookkeeping; and yet the entire crop-

raising and stock-producing regions have been served precisely as they would have been or are being served to-day by the withdrawal and transmission of $200,000,000 of reserve money requiring a contraction of credit approximating one thousand million dollars. I challenge any man in this audience to deny these statements and controvert these conclusions.

But will it be suggested that this is a large conversion of book credits into note credits at one time? Let us see. The book credits of the national banks alone are now $4,000,000,000. Therefore, the conversion of $200,000,000 of book credits into note credits is only five per cent. of the total. Again, since the aggregate of all bank deposits in corporate and private institutions is now $12,000,000,000, it would be a conversion of only one and two-thirds per cent. of the total book credits into note credits. But the fact is, that whether large or small relatively, it is wholly immaterial, as the transaction does not change the total bank credits to the extent of a single cent. This state of facts brings me to this declaration: That since bank-notes are not a legal reserve, they cannot be used to expand credit, nor will their creation result in the expansion of credit.

What we want, and this is the crux of the whole matter, is this: Place our note redemption so located in the United States that no banker will be out of the use of his money for more than twenty-four hours; and the cost of transmission paid by the Government. Then bank-note credits will be sent home when their mission is filled as directly and swiftly as now are checks and drafts; for the bankers will want the proceeds of the note credits precisely as they want the proceeds of their checks and drafts.

But will someone innocently inquire: "Will these same note credits be safe?"

No one has ever lost anything by holding Canadian bank-notes during the last fifty years. You, you American bankers, are just as clever as your Canadian brothers. If you can't work out something yourselves, you can adopt their plan.

The Banking and Currency Committee has favorably reported a currency bill to the House of Representatives, providing for an issue of credit bank notes equal to 50 per cent. of the capital of the national banks; and the method of guarantee makes such an issue

safe beyond peradventure. Our present bank-notes are a first lien upon the assets of the banks issuing them. With this law remaining in force, taking the entire history of the National banking system down to 1901, the average tax upon the outstanding note issue, after eliminating all the Government bonds deposited to secure circulation from our calculation, would have been eight one-thousandths of one per cent. per annum to secure the payment of the notes. In other words, the reserve of five per cent. for current redemption and the proposed guaranty fund of six per cent. would be sufficient to last one thousand three hundred and seventy-five years, and the annual tax of two per cent. would be sufficient to pay the average loss of eight one-thousandths of one per cent. for two hundred and fifty years. Again, assuming that the notes had not been a first lien and that the entire note issue of all the banks failing during that same period had been paid out of the guaranty fund, it would have taken twenty-two one-hundredths of one per cent., or about one-fifth of one per cent. per annum upon the outstanding notes. In other words, eleven per cent. would last over fifty years. Two per cent., or one year's tax, would last ten years.

The banks should pay the Government the same for these note credits that they are usually paying on large balances, viz., two per cent. per annum. They should also pay into the Treasury the same redemption fund of five per cent. that is now required for the redemption of our bond-secured circulation.

The first banking bill I introduced ten years ago had a graduated tax in it for regulative purposes. But I have graduated from that graduated tax, which I should now regard as an almost fatal blunder. For the amount issued would be so small that the intended purpose would be completely neutralized, since banks never have been and never will be eleemosynary institutions. Therefore they will not issue notes at a loss, which would be the case when the tax passed the three per cent. limit, if we can assume that our profit upon such circulation would be approximately what it is in Canada.

Again, banks are not going to subject themselves to the criticism of their competing neighbors, who will say that they are paying five and even six per cent. for money. Furthermore, in the long run, if you assume for the sake of the argument, that the banks

will issue these highly-taxed notes, you have only saddled this burden upon commerce; for under the pretence of these heavy taxes, you bankers will find a way not only to get the tax back, but more with it. I assert that a graduated tax is indefensible from any point of view, and that it will completely defeat its declared purpose.

Perfect facilities for redemption and freedom from cost for transportation will place note credits side by side with checks and drafts, and effect that facile interchange and transfer from one to the other which is absolutely essential to the complete and perfect accommodation of our currency to the ever varying needs of trade.

So you want clean money? Join us, and fight for it. Do you want more one and two dollar bills, and a broader and better diffusion of the gold standard? Tell your Congressman that we must substitute five and ten dollar gold certificates for some of the $300,000,000 of five dollar silver certificates. Do you want the Government to continue to withdraw ten or twelve million of your reserves each month, and so contract our commercial credits from $50,000,000 to $60,000,000 at the same time? If not, then demand that all public moneys shall be deposited from day to day in the usual way. Do you want to prevent one per cent. and one hundred per cent. money; riotous speculation half the time, and ruinous rates and panic stringency the other half? Adopt without delay the principle of converting bank book credits into bank note credits at the will of the depositor, in accordance with the demands of trade and commerce.

REFORM OF THE CURRENCY SYSTEM

ADDRESS DELIVERED BY JAMES H. ECKELS, PRESIDENT OF THE COMMERCIAL NATIONAL BANK OF CHICAGO AND EX-COMPTROLLER OF THE CURRENCY, BEFORE THE NEBRASKA BANKERS' ASSOCIATION, AT OMAHA, NOVEMBER, 1906.

I ACCEPTED the invitation to address the bankers of Nebraska upon this occasion because it seemed to me that both time and place were opportune for a discussion of the question of a reform of the

currency system under which we are attempting to carry on the vast business transactions of our business world. I think I am quite within the bounds of truth when I say that nowhere exist serious differences as to the economic wisdom and soundness of maintaining as the fundamental basis for our monetary and currency issues the gold standard of value. It is immaterial so far as the present is concerned by what process of reasoning those who opposed such a standard have brought themselves to accept it; the important fact is that it is accepted and the error of the doctrines and theories with which it was opposed has been cast aside and buried in the grave with the hundreds of other economic heresies which have from time to time been set up in opposition to the immutable and unvarying laws of trade and commerce. The elimination of this fruitful source of bitter discussion, personal recrimination, and party fury has carried with it the destroying element of political bias and partisan desire from all that which affects the treatment of monetary and banking problems in the United States, and we can approach their solution upon the sounder basis of merit, historic accuracy, scientific truth, and economic fact. I can conceive of no happier situation in which to consider and deal with a question which easily ranks with those of the very first importance among all with which our governmental authorities have to do. The currency question ought never to be a partisan political one, and now, least of all, for the differences between contending political hosts in the arena of public affairs turn on other things which appeal more to partisan imagination and partisan cupidity.

I am not unmindful of the fact that the attacks on what are termed the evil effects of so-called trusts, the inequalities of taxation, and the wrongful follies of tariff schedules, together with the dreamy and charmingly pictured benefits of governmental and municipal control and ownership, to-day attract the attention of men in public place and more than fill the public eye; but, taken all in all, no one of them is of more far-reaching importance or affects more greatly the underlying conditions of prosperity in the country than does the less alluring subject of currency reform. It is a happy circumstance that the need of a more responsive character of bank-note issue and a better adapted relation of government finance to daily business undertakings demands attention at a time when the

prosperity of the country in undoubted, its agricultural, manufacturing, and financial activities everywhere apparent and substantial, and its credit conditions healthful and sound. The demand for better things springs neither from panic nor threatened distress. It is not the far cry of the banker in the first instance, but of the men who outside the distinctive realm of finance feel how inadequate are the banks of the country, upon whom the business interests of the country rely, to meet fully and cheaply the varying demands of trade and commerce. The man who has something to exchange with his fellow, whether it be the produce of the farm or the product of the factory, whether it be daily labor, or work of less exhausting character, finds when he studies it that both in the first and in the last analysis his interest is concerned more in the extended usefulness of the bank than in any other institution in the community. It is to the advantage of all who would buy money and credit that they be obtainable when needed at no greater cost than safety and prudence make necessary, and in a form which best answers the ends to be accomplished. We are apt to lose sight of the fact that the bank was the outgrowth of the necessities of the business world and that through the activities of this "handmaid of commerce" the innumerable transactions of barter and trade in every portion of the globe have been made not only possible, but an accomplished fact. I sometimes believe the very number of banking institutions and the close relations which exist between them and the daily movements of trade have caused the public to look upon them as a matter of course, classing their field of endeavor and their sphere of usefulness with that of every other avenue of undertaking. This failure to differentiate between the pre-eminent position of the bank as the potential factor in the upbuilding of a community, by intelligently fostering and usefully directing the investment of credit, which a bank buys and sells, and general business operations, has not been wholly free from harmful effects. It, at least, has not infrequently caused both the people and the people's representatives in legislative and executive places to be wholly indifferent to the granting of such extension of powers to banks as would enable them to be of greater service, in wider fields, at a less cost to the public. And, after all, it is to the interest of the public at large more than the banker in particular that

banks should increase in strength, become far reaching in influence, and more capable of granting, on safe and conservative lines, the credit which is so much an essential necessity in the maintenance of the complex machinery of a world-wide as well as a local exchange of the things which are to be sold upon the one hand and bought upon the other.

The usefulness of the bank finds its fruition in the growth and success of the farmer not less than that of the merchant, the manufacturer not less than that of the corporation which controls the country's transportation lines. It is as essential to labor as it is to capital, and through its instrumentality adds to the efficiency of both. I am certain no banker fails to appreciate, though the public too often seems to, that the bank is the one place where the idle money and credit of every locality where a bank exists find lodgment—not for idle purposes, but that they may become active forces in the daily affairs of such locality. It takes the dollar of the single transaction and makes it bear the burden of many transactions with more direct benefit to those who buy its use by payment of interest thereon than to the bank which in its turn borrowed it from the depositor. The impossibility of there being sufficient capital at any time in any one person's possession, or in any place, to carry on a single day's exchanges must suggest itself to the person who will give the subject even the most casual investigation. The manufacturer must needs have the intervening power of purchased money and credit from the banker to make possible the meeting of a multiplicity of expenditures that are made between the period of the obtaining of the raw material and the manufacture, sale of, and payment for the finished product; so, too, the merchant, between the receipt of the finished product and the distribution of it to the jobbing or individual customer. And so on through all the gradations of the world's business life, the control and utilization of money and credit through the organized methods of the modern bank grow more and more important to every person, no matter how rich or how poor, and take a commanding position in the affairs of every intelligent, industrious, and prosperous people. The nation which is unmindful of the far-reaching force and unconquerable power of a carefully guarded, efficiently equipped, and fairly treated banking institution cannot but at the critical time fall be-

hind and ultimately fail in every contest with a people who value and foster them. If it be true that in the arbitrament of war the government which commands money and credit beats down its adversary, it is not less true that upon the fields of peaceful endeavor amid the forces of trade and commerce, the nation of great banks, utilizing every refinement of credit, will gain the vantage ground and ultimately triumph in all that goes to make up that prestige which springs from accumulated wealth, industrial supremacy, and financial power.

It is because of a full faith and an unshaken confidence in the truth of these assertions, coupled with the thought that the American people have been almost wholly unmindful, in the past, of how essentially necessary is a wise consideration of legislation which touches upon banks, money, and credit, that I am here to urge an awakening of the nation's legislative body to the vast importance of it all and an insistence that it be given precedence over mere expenditure of public funds, the creation of official place, or the formulating of issues for future political campaigns. The importance of legislative action, both as regards the note issues of the nation's banks and the better and more scientific handling of the nation's public funds on the part of the Treasury Department, has been emphasized by the recent action of the country's greatest commercial body, the Chamber of Commerce of the City of New York, and the country's most important banking body, the American Bankers' Association, who jointly, through representative men of high character, wide experience, extensive research, and practical knowledge, have formulated and presented a plan, enunciating principles which, if crystallized into law, it is believed will remedy existing defects in our treasury and currency system and be productive of general good. I accept the judgment of these men as sound and the principles enunciated as a basis of legislative enactment, as being as nearly correct as is possible under conditions where ideals cannot be attained and perfection cannot be had. It is possible that a great central bank might better accomplish results more satisfactory, but a great central bank is an impossibility in this country where political issues always prevail and where individuality in every part of the country will not surrender itself to concentrated power in the field of banking, no matter how carefully

such power is dealt with or how perfect and beneficial might be the result of its use. The legislation that is the most nearly perfect and improves existing conditions and remedies present defects must commend itself as a practical thing, and the country can better afford to take the nearest approach to the best thing than to wait still longer years for legislation without defects and enactments that are beyond question in every word and line.

The commission which sat at Washington under authority of the Chamber of Commerce and the American Bankers' Association proposes legislation which will emasculate the sub-treasury system and place the banking business of the Government of the United States upon the same rational and common-sense lines as is that of the banking transactions of the man of everyday affairs, that of every state, county, and municipality in the country. And why not? What is there more sacred about the revenues collected through the tax levies of the national Government than those of the individual states, or of our great cities, or of the accumulated funds of private capital? Is it a question of safety of funds deposited with banking institutions which are under direct supervision and control of the Federal authorities. If it is, there is a remedy and the government can readily avail itself of it. The government method of banking its receipts of revenues is the irrational method which, if followed by the individual, would spread disaster everywhere and make daily business impossible. It converts the dollar of activity into the dollar of idleness, and takes out of the channels of trade the force essential to a continuance of the flow of business undertakings. As long as the nation takes, through the force of law, from the individual citizen more than the government needs for legitimate governmental purposes, it ought in justice to him at least to attempt to minimize the wrong it inflicts by permitting the business world, of which he is a part, to have the benefit of the daily use of the surplus revenues which are accumulated. The wrong is doubly inflicted when the citizens' capital is directly lessened on the one hand, and indirectly injured on the other. If on revenues deposited in the banks by the Secretary of the Treasury interest is paid, there can be no complaint about such deposit and no charge of governmental favoritism. It, too, will put an end to the continual appeal to the Secretary to aid the money situation, for

day by day, the government will bank as others bank and all will know what the conditions are and not dwell in continuing expectancy of relief being granted from Washington. It is unfair both to the Secretary of the Treasury, no matter who he may be, and to our business undertakings, no matter what they are, that the law should necessarily create so close an intimacy between the two. Under trying circumstances Secretary Shaw has conducted the duties of his great office with rare skill and judgment, but it would be infinitely better to make the appeals in every trying time an impossibility, and such a thing can only come about by either the complete abolishment of the sub-treasury system or the rendering of it an inconsequential force in monetary movements.

I wish now to turn to a discussion of that which constitutes the more important provisions which this commission, on behalf of the commercial and banking interests of the country, will ask Congress to enact into law—namely, the enlarging of the note-issuing function of the national banks by granting them the right, under well conceived and conservative restrictions which assure safety to the public and guard the banks against misuse of the power given, to put forth promissory notes of small denominations without a specific deposit of assets to secure the same. I am aware that there are many, both in and out of banking circles, who either doubt the wisdom of such note issues or protest against them altogether. They take counsel of their fears and fortify themselves by harking back to periods when conditions existed which are now impossible.

The era of wildcat money has gone by as effectually as has that of the irredeemable greenback fallacy and the silver heresy. The world of business has moved to more intelligent periods, better devised monetary and currency methods, and a saner understanding of bank-note values. It is impossible to believe that in more than fifty years of national and business life we have made no advance as against the dangers of an ill-adjusted, badly protected, and speculative currency issue. If such is the case there is little ground for boasted American enterprise and keenness. I am unwilling to believe that such is the case, and I am equally loth to think that from the conservative councils of carefully trained men of affairs and finance should come any plan that is not sound in principle

and safe in practice. These men have brought to their years of study and historic research equal years of practical and technical experience in dealing with money and credits, and the former fits to the latter and the latter finds proof in the former, and I set over against the doubts and fears of the timid the findings of these men who have both acted and studied.

No one complains of the absolute goodness of the present bank-notes. They are sound beyond peradventure, but they bear no relation in volume or activity to the varying wants of business conditions. They are measured by the single standard of the price of government bonds as reflected by the daily quotations. It is absurd to contend that such a bank-note issue is scientifically correct or can possibly adjust itself to the business growth of an expanding country. We can better afford to try something seemingly new which research and experience proves fundamentally right, than go on with measures which, though sound in a single regard, are inadequate and wrong in every other respect. It seems to me that we have reached a point in dealing with currency questions where we can well afford to try and reach conclusions through an intelligent analysis of the facts as they are, and not as we either think they are or wish they were. There is no doubt but that ultimately the knowledge of what constitutes the underlying principles of bank-note issues will control and we shall free our minds of many misconceptions that both hamper and confuse us. I am sure the public will at no distant day accept as axiomatic the fact that bank notes are nothing but mere promissory notes issued by an institution and of value because they are redeemable upon demand in that which has recognized value. They are no more money than a bank check is money; they are only a promise to pay money and are redeemable in money. They differ only from checks because they circulate as money, are not always presented so quickly for redemption, and are of smaller amounts. They are a liability of the bank just as a book entry of a deposit in the bank's ledgers is a liability, or as checks are, only far less important as a part of the maintenance of the transaction of business. They are good or bad when not specifically secured to the same extent as bank deposits, and bank checks are good or bad, and we go to the extremes of fear and anxiety when we worry over the promissory note of small denom-

ination and accept without question the greater indebtedness of the bank as it finds expression in the book-entered liability and the check-indicated liability. The vast usefulness of a deposit currency and a check currency is acknowledged; why not supplement these efficient agencies by adding a responsive bank-note currency as an essential element to meet needs which neither the one nor the other can always provide?

But the argument is advanced that the proposed unsecured bank-note suggested by this commission will become the means of an inflation of our volume of currency which will encourage speculation on every hand and work out panic and disaster. I challenge the objection thus made as unsound because inflation never comes through an issue of notes which are quickly convertible on demand, with redemption agencies near at hand, and where the monetary standard of value upon which such notes rest is not debased. The inflation of the currency comes from a debasing of a country's monetary standard of value, and never from the issuance of convertible bank-notes. And it is equally true that speculation bears no relation to the putting out of convertible bank-notes, but finds its birth and growth and final development in the unwise and abnormal extension of bank credit, as that credit is represented by check and deposit currency. It must not be assumed that, if authority is given to the banks to issue such notes, thus creating other liabilities for those issuing them, the banker is going to become either reckless with or destructive of his own property. He, at least, will still retain some sense of duty toward his stockholders, and be possessed of some degree of enlightened selfishness as regards his own interest. In the past banks which have been successfully conducted through long years have not been so managed, because they have only put forth bank-notes with collateral security deposited with the government, to be sold for their redemption in case of failure. What the banker has found as a correct rule of guidance in the past will be accounted a safe rule in the future, and those who think a different course of conduct will intervene wholly underestimate the banking intelligence and patriotism of the country. The banker will not give these notes marking his liability away for nothing. He will sell them as the merchant sells his obligations, and he will issue them against actual existing values,

and he will redeem them on presentation on demand at the place appointed in the instrument which he has sold, just as the merchant does. The difference will lie in the smaller amount alone, and nowise in principle. Neither will the banker issue more notes than he can redeem, nor will the public accept more than the public can use and pay for, and the fact is not altered by whether the bank note is a secured or an unsecured one. I do not overstate when I say that the attempt to charge a convertible bank-note so safeguarded as it is proposed that this suggested note shall be either as a scheme for inflation or for wild speculation is wholly without the bounds of careful thought and well-considered reasoning.

There is no safeguard which conservatism demands that has failed of provision in permitting such an issue. It will have held against it a reserve of the same character and as adequate as the bank deposit liability. For its redemption there are to be agencies conveniently located so that there will be no delay in quickly converting it into money. It will be issued only against existing values and at times when there is a demand for its use. The competition of one bank's issues against another's will give added safety to the holder of it and warrants the assertion that redemption will be speedy and effective. It will be taxed that it may to an extent be regulated, and it will have as an added assurance to those who hold it the immediate redemption of it by the government, which in turn recoups itself from a tax-provided safety fund, in case of failure on the part of the issuing bank. I can think of no other protective features which could be thrown about it that would more carefully regulate its issuance or insure its daily and in case of failure immediate redemption.

I have but a single other suggestion to make, and I am done. It is upon the necessity of granting this more adequate power of note issues to the banks. To-day there is no adequate means in this country, outside of artificial and unnatural ones, of meeting the changing needs of business requirements. The granting now and then of government deposits means nothing under existing conditions. In every season of extraordinary crop movement or manufacturing activity the banks find themselves either unable to properly provide credit to those who deserve it, or if they do so the strain is so great as to cause such high rates of interest as to

lay an added burden upon every customer. The bank's assets, no matter how good, are dead in so far as being available for purposes of relief of a situation which ought, without difficulty, to be corrected. They cannot discount their paper without causing comment and criticism, and they cannot encroach upon their reserves. The resort to a bond secured note is expensive and far from speedy, and so in more than one instance the country in the midst of unprecedented prosperity has stood in the shadow of disaster because of needed banking relief. It is because of this fact that there is the demand that the banks, the properly organized agencies for caring for the needs of business, be granted the power to provide a credit currency which is not only possessed of the quality of safety, but adds to it the no less important quality of being responsive to the requirements of our highly developed and complex business world.

Such a bank-note system we do not have, and until we are possessed of it we must look for high rates of interest when we least should have them, and recurring periods of uncertainty and doubt. The stopping of one undertaking here and another there will mark our business and financial career. It cannot be otherwise.

In conclusion, permit me to quote as embodying the truth of the whole matter a single sentence from the work of a distinguished writer on political economy whose authority is recognized on two continents: "First assure the permanence of the standard, then remove all shadow of doubt as to the immediate convertibility of the media of exchange into that standard, and the expansion and contraction of the media of exchange, the currency, can be with confidence left to take care of itself." I cannot believe that the plan which is offered for legislative sanction fails in any of these respects.

INFLUENCE OF THE INCREASING GOLD SUPPLY UPON PRICES AND THE RATE OF INTEREST

ADDRESS DELIVERED BY JOSEPH FRENCH JOHNSON, DEAN OF THE NEW YORK UNIVERSITY SCHOOL OF COMMERCE ACCOUNTS AND FINANCE, BEFORE THE PENNSYLVANIA BANKERS' ASSOCIATION, AT WILKESBARRE, JUNE, 1905.

GOLD is the most interesting of all the metals. Everybody wants as much of it as he can get, and all men are concerned in its scarcity and its abundance. Any change in its value in one way or another affects the welfare of every man and woman in the civilized world. It is on this account that gold is called a precious metal. Gold derives its unique position among metal from its use as money. It is to-day almost a universal standard of prices and values. Everywhere men measure their wealth in gold, and unconsciously take it for granted that their riches are increasing in proportion as their power to get gold increases. Because gold is used as the standard of prices the average man thinks it is stable in value. All other things may rise or fall in value, but not gold—that, he thinks, is immovable.

A very little clear thinking, however, soon convinces one that with respect to its value or exchange power gold is no exception among the metals. Its value depends upon its abundance in relation to the demand for it. Any great increase in its supply must sooner or later force down its value. The reason why the average man fails to see this truth is because gold, being itself the standard of prices, has no price. Men think of an ounce of gold as being always worth $20.67, that being the amount of money into which it is coined at the mint. Now, then, can it be true, people ask, that gold changes in value when you can always sell it for the same amount of money? When the prices of things in general decline, people think it is because their values are falling. If prices in general are rising people speak of a rise in values. The truth of the matter, namely, that these changes indicate changes in the value of gold, never occurs to the practical man of affairs unless he gives especial thought to the money question.

It is unnecessary to develop any fundamental principles with regard to the nature or value of money. We have before us a concrete question: What is likely to be the effect of the increasing supply of gold upon prices and the rate of interest? The facts

which have suggested this topic are doubtless familiar to all of you. During the last ten years the output of the world's gold mines has been increasing at an unprecedented rate. In 1890 it amounted to $119,000,000; in 1895, to $200,000,000; by 1899 it had increased to $307,000,000 per annum, and in 1904, according to the estimate of our director of the mint, it amounted to over $350,000,000. When we consider that during the first fifty years of the nineteenth century the total output of both gold and silver was less than two billion dollars, while the output of gold alone in that period was only $800,000,000, or about $16,000,000 per annum, whereas in the last fourteen years the output of gold has amounted to nearly three and one-half billion dollars, it is not surprising that very grave questions arise in the minds of thoughtful men with regard to the probable future of the value of gold, and with regard to the effect upon human welfare which changes in the amount of gold will exert. Can the world absorb $350,000,000 of new gold, or must its value fall in order that a place may be made for it in the markets? If its value does fall, we know that prices must rise. How will this rise of prices be brought about? Will it be steady and gradual, or will it be sudden and spasmodic? What effect will it have on the business enterprises of men? Will it lead to speculation and panic? Will it have any influence on the rate of interest?

In order to bring out my answers to these questions in an intelligible, if not logical, order, I propose to consider the subject from three different points of view. First, how does an increasing supply of gold tend to affect prices? Second, does it have any relation to the rate of interest and the money market? Third, what are the conditions which govern the production of gold, and do these conditions now warrant an expectation of a continued large increase of the supply?

In order to avoid confusion, it is necessary to have clear ideas as to the meaning of the words we use. Unfortunately the word money is often employed in different senses. In my opinion, in its scientific and proper use it means the standard of prices, that valuable thing which men use as a medium of exchange or means of payment, everyone being willing to accept it. In its popular use, however, this idea is confused with various forms of credit. Most people think of the greenback, silver dollar, and bank note as

money. These things are not money in any proper sense of the word. They are all promises to pay money. They are representatives of money. They possess, as it were, the power of attorney for money, and so are able in the business world to do almost everything that money itself can do. Again, you bankers use the word in a peculiar sense. When you speak of money as being scarce or "tight" you do not mean that there is less gold or currency than before; you mean merely that your lending power is exhausted; that the ratio between your reserves and your liabilities is near the danger point. Money when used in this sense in the financial world is really equivalent to loanable funds or capital. In what I have to say I shall endeavor to use the word money in what I have defined as the scientific sense. To cover the popular usage of the term, I shall use the word currency, which may properly enough include all generally acceptable media of exchange, such as gold, greenbacks, silver dollars, bank notes; and when I have in mind what is sometimes called bankers' money I shall speak of loanable funds.

In discussing the probable effects of the new gold upon prices, we must first consider the part which credit plays in the making of prices. Some writers have put forth the view that credit in the modern world is of such great consequence that mere changes in the volume of gold cannot produce any great changes in the prices of goods. In my opinion, this view of the subject is a mistaken one. Credit is merely an auxiliary of gold. It increases the efficiency of gold just as rapid-fire guns increase the efficiency of the battleship. The more extended our credit system, the greater the number of exchanges that can be mediated by an ounce of gold. A dollar in a bank will do five times as much buying as a dollar in the street. Modern credit, instead of lessening the importance of each ounce of gold in the world, has greatly increased it, for every ounce of gold can now be made the basis for credit transactions much exceeding in volume the value of gold.

I do not mean to imply that the present general use of credit as a medium of exchange can be ignored, or that it does not complicate matters. It has given rise to an important new demand for gold; namely, to serve as a basis for credit, or as a banking reserve. Banks do not voluntarily carry more gold, or reserve, than they deem adequate to meet their demand liabilities. But a proportion

of reserves to liability which is considered adequate at one time is not adequate at another. The basis of credit is confidence, and when confidence is lacking, or is threatened, the banker everywhere increases the hoard of his reserve, thus preventing gold from having any effect whatever upon prices. But when the situation changes, and hope takes the place of distrust, then the bankers' reserve, through the agency of credit, becomes a quick and powerful stimulus to prices. We need not expect, therefore, a steady and gradual advance of prices to result from the present outpour of gold. We may expect spasmodic upheavals of the price level, and then periods of depression. So long as we use so sensitive an instrument as credit in trade, no matter how greatly the world's supply of gold is augmented, we need not look for a steady or orderly upward movement in the prices of goods.

Let us consider a concrete case. Let us suppose that the supply of money in the United States has been greatly increased during a certain month by an influx of gold from the mines of Alaska, California, and Colorado. Most of the miners will make the natural and reasonable disposition of their money; each will spend more or less for the satisfaction of his present wants; will keep a certain sum for the satisfaction of future wants; and will either lend the balance or deposit it in a bank. That portion which is spent will constitute a new demand for certain classes of goods, and will tend to raise their prices. That portion which is loaned will be expended by the borrowers in the purchase of goods and payment of wages, and will tend to advance both prices and wages.

Let us suppose that the banking reserves of the country are increased $50,000,000 by the deposits of these miners. Will this money lie idle and so have no effect on prices? Certainly not. It will be the most potent part of the new supply. Bankers are the last people in the world to look with complacence upon a hoard of idle money. Their dividends depend upon their power to make a dollar do twofold or fourfold work. The banks that receive this $50,000,000 of new money will not rest till they have found borrowers, even though they are obliged to lower their rate of discount. This $50,000,000 may be made the basis for an expansion of bank credit to the amount of $200,000,000, or even $300,000,000, and the borrowers of this credit will buy goods and labor. Thus this new

gold, in the form of currency or credit, will gradually increase the demand for various goods, and so cause their prices to rise. Since there is no reason why the demand for goods should have fallen off, the general price level will have been raised, indicating a decline in the value of money.

In the foregoing illustration, I have tacitly assumed that none of the new gold is taken by jewelers and others for use in the arts, and this assumption is justified, for there is no reason for supposing that the demand of manufacturers for gold will increase until gold has actually fallen in value—that is, until the prices of goods have risen. Of the new gold added to the world's stock each year, it is estimated that 20 per cent. is absorbed by the arts demand, but there is little evidence that the consumption of gold in the arts increases much as the value of gold falls.

Prices never change uniformly. In a country like the United States, where business is done largely by the aid of banks, the credit system being highly developed, an increase of the volume of money affects, first, the prices of stocks and bonds, for these are the articles that are bought by the man into whose hands the money first naturally comes. The prices of such speculative commodities as wheat, cotton, corn, steel, etc., are affected almost as quickly; not the prices of all at the same time, but first one, then another. If there is a great speculative interest in wheat, and little in other produce, new money and the credit it supports may all go for a time into the purchase of wheat. On the other hand, it may all go into the stock market. After a time, however, it will get into general circulation and affect the prices of most commodities, touching first wholesale prices, then retail, and finally real estate, wages, and salaries.

This process of readjustment is a slow and gradual one. A study of the course of prices during the last few years (1897-1904), when the general level has been lifted some 25 per cent. by the great increase in the world's supply of gold, will show that some articles have doubled in price; that others have made only a slight advance, and that still others have not changed at all; that wages in some occupations have advanced, and that in others the old rates are still paid.

The effect of increasing gold supply upon the rate of interest

is an indirect one. It grows out of the change in prices. The rate of interest in the last analysis has no relation whatever to the quantity of gold in the country. It is the product of the demand for and the supply of capital. This word capital is used by the economists to mean all those forms of wealth which are used in the production of more wealth; such, for example, as machinery and raw materials. It includes all those goods which are not consumed directly, but which are used to produce things that people desire. Among business men and bankers the word has a different meaning. It denotes a loanable fund for use in business, and consists of money and credit in various forms. It is important for us to see that the business men and the economists both have in mind the same thing when they use the word capital. The loanable funds in the possession of banks are all derived from the loanable capital in the country. When the amount of loanable capital increases, the amount of loanable fund increases in a responding degree; and there can be no real increase of loanable funds brought about in any other way. Banks create nothing. All their lending power is the product of industry. Every deposit of money or credit in a bank represents actual wealth or capital that has been saved in a community. The loanable capital and the loanable funds of a country are practically the same thing: the one a heterogeneous mass of value in the form of various goods; the other the same mass of value made homogeneous by the universal solvent, money. Nevertheless, business men usually think of the rate of interest as determined by the money situation. They assume that a high rate indicates a need of more money and that a low rate is due to a plethora of money. We have here a confusion of money with capital which has led to mischievous legislation in the past and is to-day the basis of worthless remedies proposed for the relief of the money market.

Although the rate of interest, strictly speaking, depends upon the demand for and the supply of capital, yet changes in the supply of money great enough to produce changes in the prices of goods are always accompanied by variations in the rate of interest For example, it is clear enough that a large increase of the gold supply, such as that imagined a few minutes ago, must cause a temporary decline in the bank rate of discount. Apparently it increases the lending power of banks. I say apparently, for,

mind you, it does not in any way increase the real capital of the country. The final result will be a rise of prices, and a fall in the real purchasing power of the dollars which are loaned by bankers. The first effect of an increasing gold supply—namely, a decline in the rate of interest—will be only temporary if the supply of gold continues to increase so that prices preserve an upward tendency; for forces soon get to work which tend to lift the rate of interest above the normal.

The uneven uplift of price has a remarkable psychological effect. Few men suspect that their ability to sell goods at high prices is in any way due to an increase in the gold supply. Men do not stop to consider the fact that the value of money has changes. To the business man a dollar is a dollar; he measures his prosperity in dollars; if the number of dollars into which he can convert his property is increasing, he takes it for granted that his wealth is increasing at the same pace. As a result, therefore, of a steady upward tendency of prices and of the consequent increase of what may be called the "money wealth" and "money profits" of business and industry, men in business are eager to extend their operations. Newcomers rush into industry and business from the professional and other fields. Lawyers turn promoters for the development of oil fields or for the construction of street railways. Teachers and physicians abandon their callings and study the A B C of Wall street.

All this rush into the industrial field must evidently be accompanied by an increased demand for capital, and bankers who are also affected by the contagion of the time, find that they can extend their credit to the utmost limit at an unusually high rate of interest. In other words, the increase in money profits brought about by the maladjustment of prices arouses an artificial demand for capital, and so lifts the rate of interest above its normal level, or that which it would have held if prices had not been disturbed.

How long the industrial body can stand the effect of this money intoxicant, gradually administered, experience alone can decide, and experience seems to teach the lesson that final disaster, however long deferred, is inevitable. It is certain that no mere change in the relation between the demand for and the supply of money can produce changes in the wants of men sufficient to justify remarkable

changes in the production of wealth. All this expansion of credit and abnormal demand for capital are usually attended by a confident popular belief that at last a period of good times has arrived which can have no end. Wild speculation ensues in this or that commodity—in real estate, in railroad stocks, in wheat, in cotton—and numerous enterprises are undertaken far in excess of the immediate demand. Some morning a well-known firm or corporation whose ventures have entailed unusual risks is notified by its bank that some of its outstanding paper must be taken up. Unable to realize on its assets without great sacrifice, it calls upon some of its own debtors for payment, but they, too, are unprepared for immediate liquidation. The next morning the newspapers announce the suspension of that firm, and rumor runs through the streets crying that many other important houses are affected. The more timid creditors bring pressure to bear upon their debtors for payment. Another big corporation fails and drags a bank down with it. Then there begins a general scramble on the part of all for the payment of debts due them. No man dares trust his fellow. Credit almost disappears from the business world, and prices fall with a velocity that brings ruin to every weak bank and business concern, and to many others whose solvency, if no panic had come, would have been strongly buttressed.

During this collapse and panic the rate of interest rises to abnormal heights. There is now a scramble for loans, not for use in the production of wealth, but for use in the payment of debts. After the panic is over and the wreck has been cleared away, there follows a period of dullness and the rate of interest will be as much below the normal as it was above it before the panic.

If the money supply continues steadily to increase, the time will soon come again when men, tempted by the low rate of interest and by restored confidence in the country's resources, will once more make the round of borrowing and producing. In the meantime, a new generation comes upon the field, lacking the experience of its elders; again new enterprises are floated; and the cycle of unwise production, speculation, and panic is repeated.

Since 1897 the United States has passed through one of these periods of rising prices, rising rate of interest, and increasing bank deposits. The first check came in 1901 and a greater check in 1903.

After a year of rest and recovery the country appears now to be swinging up on another wave of prosperity. Both reason and experience unite in leading us to expect that the end of the Japanese-Russian war will be followed by a release of credit, another upward shoot of prices, and a demand for capital that will bring large dividends to bankers all over the gold-using world. How and when this next period of prosperity will end, depends very much upon the power of bankers to remain conservative and keep their heads.

I am aware that what I have said is in opposition to the common view upon this subject. It is usually taken for granted that the present outpour of gold is going to result in a decline of the rate of interest. This view I am certain is a mistaken one. It rests upon a superficial view of the facts. Had we the time I should undertake to show you that a decrease in the gold supply, or in the money supply, such as this country endured between 1810 and 1840, must tend to keep the rate of interest below the normal. This part of the subject, however, at the present time has only academic interest.

Lest you think me altogether theoretical, let me ask you to consider briefly the statistics of the London money market during the nineteenth century. London adopted the gold standard in 1816, the price level thereafter being determined by the value of gold. The world's stock of gold available for use as money was decreasing between 1810 and 1850, and we should expect during that period a decline in the London rate of interest. The statistics do not disappoint us. In 1824 the market rate in London was 3.5 per cent. The panic in 1826 made the average rate for that year 4.5 per cent. By 1833 the rate had fallen to 2.7 per cent. There was a slight rise in succeeding years, due largely to the expansion of credit. The panic of 1839 raised the rate to 5 per cent. Thereafter there was almost a steady decline until the panic year of 1847, when the rate rose to 5.9 per cent. In the next five years the rate almost steadily declined, until in 1852 the average rate was only 1.9 per cent. At this date new supplies of gold from Australia and California were making their way into Europe, and the interest rate took an upward turn in London, being 3.7 per cent. in 1853, 4.9 in 1854, 4.7 in 1855, 5.9 in 1856 and 7.1 in the panic year 1857.

The interest rate fell to 3.1 in 1858 and 2.5 in 1859, rates which were doubtless below the normal. In 1860 a rise began again, the rate being 5.5 in 1861 and 6.7 in 1866, the next panic year. Thereafter there was an immediate decline, the rate for 1867 being 2.3 and for 1868 1.8. Then followed a slight advance of the rate until 1873, when the average rate was 4.5 per cent. Here set in a gradual decline of prices due to a relative decrease in the supply of gold, the supply not increasing so rapidly as the demand. It was accompanied in London by a constant tendency of the rate of interest to fall, although there were occasional advances caused by the expansion of credit. The average market rate in London in 1894 was 1 per cent., and in 1895 .8 of one per cent. per annum. After 1895 the effect of the new gold from South Africa began to be felt in England, and the interest rate again began an upward journey. Prices of commodities in England between 1896 and 1902 rose something like 25 per cent., and the rate of interest rose from eight-tenths of 1 per cent. in 1896 to 4 per cent. in 1903.

I need not take your time to go over the statistics of the New York market. Since 1897 prices in the United States, according to the statistics of the Bureau of Commerce and Labor, have risen some 25 per cent. You will know what has happened to the rate of interest. In 1897 commercial (double name sixty days) paper sold in New York around 3½ per cent. There were only fifteen weeks during which it rose above 3½ per cent., and it never went above 4½ per cent. For sixteen weeks it did not rise above 3 per cent. In 1898 the rise of prices began and the rate of interest followed suit. It touched 5 per cent. during nine weeks, and 6 per cent. during seven weeks. In 1899 it reached 5 per cent. during twelve weeks, and 6 per cent. during thirteen weeks. It averaged over 4 per cent. throughout the year. In 1900 and 1901 it averaged about 4½ per cent., sinking below 4 per cent. during only a few weeks each year. In 1902 the rate never fell below 4 per cent. The rate was 5 per cent. and higher for fourteen weeks, and 6 per cent. plus commission for twelve weeks. In 1903 the rate continued between 5 and 6 per cent. throughout the year. There was a decline in 1904, but the rate closed the year at 4½. This decline in 1904 was the natural sequence of the break in the stock market in 1903 and the resultant loss of confidence among

business men. The loanable funds withdrawn from Wall street sought employment in the world of industry and trade, and a decline in the rate of interest was inevitable.

Conjecture with regard to the future course of prices and the interest rate must take into account the fact that during the last seven years great commercial nations have been continuously at war, and that in consequence a normal expansion of credit has been impossible. Since 1895 the gold holdings of the great banks of the world, including the national banks of the United States, have increased by over one billion dollars; but much of this new gold, instead of being given employment in the world of trade and industry, has been hoarded in banks to provide for the extraordinary contingencies of war, both actual and possible. Not until the world's peace is comparatively assured, will credit take wing and bring all the new gold into potential contact with goods and securities. Concerning the precise effect upon prices and the rate of interest, we can only speculate; but that prices must tend upward and the money market be subject to violent disturbances, we can be reasonably certain.

We now come to the third part of my subject. Will the gold supply of the world continue to increase at the present unprecedented rate? Is the production to be $400,000,000 this year, $450,000,000 next year, and one-half a billion in 1907? If such a deluge of gold awaits us, it is impossible to escape the conclusion that the purchasing power of gold must suffer a great decline and the civilized world pass through an era of wild speculation in the stocks of corporations and in the prices of commodities. Fortunately there are some good reasons for hoping that no such future is in store for us. Gold mining is an industry in all essential respects like other industries. Its output tends to increase when the value of the product is rising, and to decline when the value of the product is falling. That the production of any ordinary commodity tends to decrease when its value is falling, is a truth well understood by all business men, but its applicability in the case of gold is not clearly seen. As we have seen, the value of gold seems stable, so that it does not occur to the average man that the profits of gold mining are affected in any way by changes in the value of gold. He sees clearly enough that the profits of iron mining de-

pend upon the prices of iron, or of copper mining upon the price of copper; but the profits of gold mining seem to him to depend upon the quantity of gold mined and to vary as that quantity varies. The owner of a copper mine has his eye upon the price of copper; the farmers of Iowa, Nebraska, and Minnesota are interested in the price of wheat; it is upon these prices that their profits depend, but the gold miner studies no market report. He will find the price of gold published in no paper. Is he not, therefore, engaged in a most unique industry, in one the profits of which are independent of market fluctuations?

Curiously enough, the gold miner is more interested in prices, though not consciously, than any other purchaser. He is interested in all prices, for the value of his product varies with every change in the price of goods in general.

The relation of the gold miner's profit to general prices can be made clear by illustration. Let us suppose that a man owns a gold mine in Colorado from which he is getting an ounce of pure gold a day. This gold, if we make a slight deduction for the expense of shipment, purification, etc., may be supposed to yield him $20. How is he concerned about the prices? Let us suppose that when he opened his mine the prices of food, powder, tools, etc., were such that his expenses were $10 a day. His daily profit, therefore, was $10. Suppose that during the course of three years prices rise fifty per cent. His daily expenses are now $15 and his profits have been reduced one-half. If prices go on rising, his profits will go on decreasing until a time will come when he will abandon the gold mine as no longer profitable, even though in any one day he is able to get as much gold from it as before. A fall of general prices would produce the opposite effect upon the miner's profits; he would find his expenses growing less and, therefore, his profits increasing. A rise of prices would lessen the amount of gold which he could lay by and also lessen its value to him, for its purchasing power would be reduced; a fall of prices would give him double satisfaction: it would enable him to increase the daily increment to his store of gold and would also add to its purchasing power.

Since all gold miners must be affected the same way as our single miner by changes in the level of prices, it is clear that a rise of prices must lessen the profits of gold mining, and that a fall of

prices must increase his profit. The industry of gold mining, like all industries, is carried on under diverse conditions; some mines are very profitable, while others barely pay the cost of operation. At all times mines are being worked which yield only the ordinary rate of profit, and these are the ones first to be abandoned when prices rise. These mines may be called the "marginal" mines, and the cost of mining gold in these is the cost with which the value of gold tends to conform. As the value of gold falls—that is, as prices rise—the expenses of gold mining increase, and marginal mines are abandoned. The world's output of gold being thus diminished, the rate of increase in the world's stock of gold receives a check, and the downward tendency of its value is also checked. On the other hand, when prices are falling because the demand for gold is outrunning the supply, poorer mines are brought within the field of profitable operation and a gradual but steady increase of the annual output sets in. Furthermore, since falling prices are often accompanied by a depression in many industries, the attention of men is more than ordinarily directed to the profits of gold mining, and prospectors go out in unusual numbers in search of new mines. As a result, a fall of prices is usually followed, not only by an increased output from old mines, but by the discovery of new fields of gold, the yield from which finally so augments the supply that the value of gold begins to fall and the prices of goods rise.

Evidently if we only knew what profits were now being made in all the gold mines of the world, it would be an easy matter to discover the marginal mines, and determine how the production of gold would be affected by any further uplift of the general price level. If we should discover that most of the gold now taken from the earth was got out at a cost of $10 an ounce, we should have reason to expect a continuation in the recent large output, even though present prices nearly doubled. Unfortunately we have not the figures necessary for such an estimate. I learn from our director of the Mint that the dividends upon the Rand property in South Africa amount to about 30 per cent. of the product. About 40 per cent. of the great Treadwell mine in Alaska is distributed in dividends. The Oriental Consolidated Mining Company in Korea is also said to be making net profit of 40 per cent. Mr. Roberts is of the opinion that the quartz mines of California and

Cripple Creek average much less than 40 per cent. This is a phase of the subject in which further investigation is necessary, and the results of that investigation must be of tremendous consequence to bankers as well as to business men.

In the past the production of gold has been in great cycles, as our theoretical consideration of the subject would lead us to expect. And these periods of increasing and decreasing production have been attended by corresponding cycles of rising and falling prices. Unless men find some new way of getting gold from the earth, or discover mines where gold can be quarried like iron or coal, we have good reason for expecting that the present era of abundant and cheapening gold will be succeeded by one of relative scarcity, and that the course of prices in the future is destined to be like that in the past, now falling for twenty years or more, and now rising.

THE FINANCIAL OUTLOOK

ADDRESS DELIVERED BY FRANK A. VANDERLIP, VICE-PRESIDENT OF THE NATIONAL CITY BANK OF NEW YORK CITY, BEFORE THE ILLINOIS BANKERS' ASSOCIATION, AT THE LOUISIANA PURCHASE EXPOSITION, ST. LOUIS, MO., OCTOBER, 1904.

It has seemed to me especially fitting to attempt to review, in the briefest manner, a few of the figures illustrative of our material progress, and to try to draw some deductions from them. In order to get a setting for our comparisons, let us for a moment glance back at conditions during the last ten years. We will remember that we were, ten years ago, just emerging from the depression of the panic year of 1893, and that we were facing a great political and economic conflict over the silver issue. The whole world was filled with distrust in regard to the future of our standard of value, and the chilling shadow of that distrust was falling heavily on our commerce and finances.

Then came the definite verdict of the people, declaring for a sound currency, and following that began an unexampled era of prosperity such as no other country, in any age, has ever known. The expansion went beyond all the experiences of men of affairs.

We had learned lessons of economy, of careful management, and of cheap production in the depression which followed the panic of 1893, and now we suddenly wakened to the fact that we had obtained a grasp on the markets of the world. Our exports of manufactures ran up from $183,000,000 to $433,000,000 in half a dozen years, and this increase of $250,000,000 in the annual average of our exports of manufactured products made Europe stand aghast at what was denominated the American commercial invasion. Our general foreign trade balance assumed such totals as to cause economists seriously to consider what was to happen to the rest of the industrial world if this march of progress went on. In half a dozen years we piled up against other countries a trade balance in our favor of more than $2,600,000,000—a trade balance far larger than the net trade balance had been from the beginning of our government down to the time when this remarkable expansion started.

And then we made mistakes. We were in the midst of a prosperity so great that it went beyond the experience of the most experienced. With the flood-tide of this prosperity covering all of the old landmarks, it was small wonder that there were blunders made in steering the craft of business. We ran into excesses, extravagances, and miscalculations. Capital made mistakes of overcapitalization; labor made mistakes of arbitrary and unwise demands; everybody made mistakes of extravagance. Producers made errors in estimating the demand and made miscalculations in the multiplication of their productive capacity. There was a surplus demand above our productive capacity, and that demand went knocking at the door of first one factory, then another and another, producing the impression on the mind of each individual manufacturer that the demand legitimately pressing upon him warranted him in doubling his plant; and when everyone started to double his productive capacity, capacity soon ran ahead of demand.

The railroads were caught in much the same situation. They made huge engagements for expenditures which they felt were necessary in order to handle the traffic that was pressing on them. For the time being, far too great a portion of liquid capital was absorbed into fixed forms of investment. Directly and indirectly, bank credits which were payable on demand were, in a dangerous

proportion, converted into new manufacturing plants and into new railroads, tracks, equipment, and terminals. Bank reserves fell until they were a danger signal pointing with certainty to the need for more conservative administration. Banks applied the financial brakes of higher and higher interest rates. Stock-market values, unduly inflated by the spirit of optimism which was all-pervading, began to melt.

Just two years ago this turn came. The decline which followed cut a billion dollars off the value of securities in a few months. The vast readjustment which such a change in values made necessary was accomplished, however, without panic, without great failures, and with few of those disasters which usually are the features of such a period. The way the country met the situation stands to-day as the most striking monument we have yet reared to our increasing wealth and financial strength.

We have grown used to cycles in business; to regular periods of expansion followed by years of depression. These cycles have been of varying length, but, generally speaking, a decade would measure the time from one upturn to the next. Men of experience, therefore, expected that the depression which started two years ago would have to run something like the usual course, and would last at least for three or four years before we had again learned lessons of economy and had settled down to a solid basis upon which to rear a new structure of prosperity. I have said that the experience of the most experienced had been set at naught by the rising tide that had marked the last great wave. Experience proved a poor guide in measuring the upturn; will it likewise be at fault in measuring the period of depression? Is the depression to be of shorter duration than in former business cycles? Have we already reached, after two years' down-grade, a level from which we can again start up to new heights of business expansion? I cannot answer these questions, but I want to present a few statistics that I believe have some bearing upon them.

What I have now to say has absolutely no application to the immediate course of the stock market. Whether stocks will be higher or lower to-morrow, next week, or next month, I do not know, nor am I particularly concerned. The fluctuations which mark the little surface waves are not matters of such moment. It

has seemed to me, however, that it will be interesting, in view of the present condition of business affairs, and appropriate, considering the place which has been chosen for this meeting, to make some comparison of business statistics to-day with conditions of ten years ago, and note what our position will be ten years hence, if the material development of the United States is to go on at approximately the same rate of progress which has marked the development of the last ten years. I believe it is fair to assume that, generally speaking, something like that rate of progress will be maintained. Certainly the outlook to-day, with currency uncertainty giving way to a securely fixed standard of value, with a sound and satisfactory banking position, and with no left-over panic consequences to be reckoned with, as was the case ten years ago—certainly such a situation offers reason for the presumption that we are in as favorable a position for development in the next ten years period as we were at the beginning of the last.

Ten years ago we had a population of sixty-eight millions; to-day it is eighty-two millions; and ten years hence, with this ratio of increase, the population of the United States will be ninety-eight millions. We shall in the next ten years add to our number a population equal to one-half that of France. Such growth in numbers, matched to our wealth of resources, makes the sort of material out of which to shape an entirely new level of statistics marking the country's material progress.

The total wealth of the United States, according to the best estimates which we have, has risen in ten years from $75,000,000,000 to $106,000,000,000. Ten years more of increase will make the wealth of this country $140,000,000,000. When we remember that such a total will compare with the total of $42,000,000,000 in 1880, the accumulation is seen to be at a rate almost incredible.

Our money stock has increased in ten years from $1,600,000,000 to more than $2,500,000,000 and every dollar of it is sound, and every dollar of it is on a parity with gold. The actual gold stock itself increased in that period $250,000,000. If the money stock increases in the next ten years in the same amount, we shall have $3,400,000,000 of circulation at the end of that period. Incidentally, it is interesting to note that national bank-note circulation in the last ten years has risen from $172,000,000 to $411,000,000, and one

might stop to wonder, if this rate of increase is to go on, where the government bonds are to come from in the next ten years to provide for a further increase of national-bank circulation of $250,000,000 or $300,000,000. Such inquiry points inevitably to the necessity of some change in our national banking laws, in the due course of time.

National-bank deposits in ten years have doubled, going up from $1,600,000,000 to $3,300,000,000. State-bank deposits in that time have trebled, marking an increase from about $660,000,000 to $1,900,000,000. A careful estimate of the total bank deposits in the United States to-day—national, state, savings banks, and trust companies—brings them up to a grand total of $10,000,000,000, and that compares with a total ten years ago of $4,600,000,000. The increase has been well over double. Will it double again, and shall we have $20,000,000,000 deposits in 1914? If we only make the same actual gain, we shall have over $15,000,000,000; and, barring any unexpected interference with our expansion, I believe that that is a conservative figure and inside the probabilities. Take the case of the institutions that each of you represents. Do you not anticipate as much growth in the next ten years as you have had in the last? If you do, and if those anticipations are fulfilled, and the increase is general, the total of banking resources at the end of another decade must certainly be an astounding one. Your own banks in Illinois have far outstripped the average of the country. The total deposits of national and state banks in Illinois have increased in ten years from $213,000,000 to $572,000,000. Why should they not make similar gain in the next ten years and Illinois deposits stand at $800,000,000?

In ten years we have seen railroad gross earnings increase from $1,200,000,000 to $1,900,000,000. With only an equal actual increase, we shall have railroad earnings of $2,600,000,000 ten years from now; while, if the percentage of increase of the last decade were to be maintained, the figures would reach $3,000,000,000. The lower total is the fairer presumption. With gross earnings reaching such a figure, however, with constantly improving methods of administration, and with more perfect roadbeds and equipment, we may expect to see steadily increasing economy of operation. Is it not fair to presume, then, that these vast gross earnings, coupled

with a decreasing ratio of expenses, will most certainly provide for an increasingly satisfactory return upon railroad investments?

I will not weary you with too many statistics. If you are interested in pursuing such a line of inquiry, get the *Monthly Summary* of the Bureau of Statistics from Washington. In its way, it is as great an exposition of statistics as is this World's Fair an exposition of material things, and it will well repay study. You will see from the figures which you will find there, for instance, that our foreign trade, which ten years ago footed $1,500,000,000, was this year $2,450,000,000. Our exports of agricultural products may not increase much from present figures, but it is safe to say that our increasing command of foreign markets for our manufactures will perhaps bring the total of our foreign trade to $3,000,000,000 in the next decade. You will see that national-bank loans and discounts, which were under $2,000,000,000 ten years ago, are now $3,725,000,000. A similar increase would carry us above $4,500,000,000 in national-bank loans ten years hence. Let us hope those loans will not increase with unconservative rapidity. Bank clearings of the country have increased two and one-half times in ten years. If progress were to continue at this rate, we should show bank clearings of more than $200,000,000,000 at the end of the next ten years. You will find that the total mineral production of the United States had increased in value from $650,000,000 to double that figure. If there is reason to suppose that this increase will continue, we shall yet make a record of $2,000,000,000 as the annual product of our mines. Our production of steel has doubled in ten years. The value of the product of our cotton-mills increased 52 per cent. The volume of business, as measured by the receipts of the Post-Office Department, shows almost 100 per cent. increase, those receipts coming up from $75,000,000 in 1894 to $144,000,000 for the present fiscal year.

These illustrations might be definitely continued, but I have given enough to point out the one conclusion which I wish to emphasize, and that is that you men who administer the great banking resources of the State of Illinois need to keep constantly before you some of these broad statistics of our material progress. Their study cannot help but be encouraging and useful. They must lead to the conclusion that, in the combination of population and natural

resources, we stand, as a country, absolutely unrivaled, and with nothing to balk our progress but our own mistakes.

If we look abroad, we see England struggling under most adverse conditions, a great portion of her industrial population actually underfed, and a million people receiving aid under her poor-laws. We see in France a nation grown rich by thrift, a nation where economy had become a disease, and in the growth of it all initiative for new accomplishments has been lost. In Italy we see a great industrial awakening, but conditions still so hard that a large percentage of our 800,000 of immigrants annually come from that country. In Germany we find a barren land yielding from the fields most meagerly and from the mines hardly at all, but with a population whose energy, intelligence, and education have built out of most discouraging conditions a vast industrial organization which is our one real competitor in the markets of the world. If we will accept from the Germans something of their scientific methods, their carefulness, their thoroughness, and their willingness for hard work, and bring such qualities to bear upon our own resources, the figures which I have been quoting as possibilities of the future will yet look small.

These statements are generalities intended to apply only over considerable periods. That the next ten years are to see to some extent a repetition of the development of the last ten is, I think, a fair presumption. Whether that upward movement has already started, or whether it is to start next month or next year, I do not profess to know, and nothing that I have said should be taken as indicating the fixing of a definite date in regard to returning prosperity. Business to-day is unsatisfactory in many respects. The memories and sore spots which the declines of the last two years have left will make many people slow in accepting the conclusion that we are ready for another great commercial advance. We are always in danger of overdoing, and we may for the moment, perhaps, have already made that error, for prices have shown most substantial recovery—a recovery certainly in advance of what would be warranted by the present actual conditions. It is safe to say, however, that we are to-day in a sound financial position. Bank reserves are ample; at least national-bank reserves are. Bank loans and discounts are not of a character to offer grounds

for any general criticism. We have probably fully paid off the foreign indebtedness in the shape of finance bills which two or three years ago had reached large totals. We are in a position to command international credits, and to bring gold to strengthen our reserves, if we should need it. We have a corn crop that is worth $1,000,000,000, a cotton crop worth $600,000,000, and a wheat crop worth $412,000,000. The value of these three crops alone this year is $2,012,000,000, which compares with the value of these same crops ten years ago of $1,067,000,000.

We have learned some valuable lessons in finance, and the memory of the last two years, reminding us of the results of the mistakes made at the height of the boom period, is still keenly enough in our minds to warrant the belief that we shall administer our financial affairs with a fair degree of common-sense for some time to come. We have learned that there is not a new political economy, but that, in spite of our vast resources, our growing wealth, and our recuperative power, we must obey the same old sound laws of finance and commerce that have long ruled.

I am convinced that the possibilities of another great business expansion are at hand, but connected with those great possibilities are great responsibilities. Those responsibilities are largely on our shoulders. The bankers of this country will, in the wisdom of the administration of their trust, or in their lack of wisdom, have great influence on the beginning, the extent, and the length of this next period of prosperity.

I cannot too strongly emphasize my belief in the importance of having our banks and financial interests prepared to play their proper part in the return of prosperity and the further development of business. We need banking laws that are wise and banking administration that is wise. Encouragement to a wild speculative boom, at this time, when improvement is justified more by hopes and possibilities than by immediate actual conditions, might set the whole period of recovery back a month, six months, a year. A great speculative boom now is not what is needed. It is indeed one of the special dangers. If bankers in the great centers are conservative in the inducements they hold out to secure deposits, and accumulate great stock of money which will loan at such low rates

as to encourage unduly a speculative spirit, they will strike a blow at this returning prosperity which may long delay its coming.

There is another danger in the banking situation. During the heights of the last commercial expansion people so lost their heads as to excuse their extravagant and foolish actions by saying that there was a new political economy, that the old laws no longer applied under the new conditions. They were wrong, lamentably wrong. And to-day a thing for bankers of this country to remember is that there have been discovered no new laws of finance which make banking without reserves safe and conservative. A bank holding money repayable on demand must keep a fair proportion of that money in its vaults. The experience of all financial history points to that necessity. Whenever that law has been violated, disaster has ultimately followed. Do not permit yourselves to believe that there has been any new discovery in finance which will safely permit banking without reserves.

I believe that the conditions are again favorable to a return of prosperity. I believe it is time for optimism. So long as we remember in humbleness our mistakes and hold close to a proper conservatism, the course of financial events seems likely to follow only one general direction, and that is toward improvement, toward expanding business, and toward better times.

PART III

TRUST COMPANY SECTION

THE TRUST COMPANY AS A FACTOR IN THE FINANCES OF THE NATION

ADDRESS DELIVERED BY FESTUS J. WADE, PRESIDENT OF THE MERCANTILE TRUST COMPANY OF ST. LOUIS, BEFORE THE FIRST CONVENTION OF THE MASSACHUSETTS BANKERS' AND TRUST COMPANY ASSOCIATION, AT BOSTON, JUNE 21, 1905.

THE trust company is not only an established American institution, but one which, if its growth continues in the next decade as it has in the past, with its combined force will shortly rival in point of actual resources that of the great national banking system of this government. Doubtless such a statement will greatly surprise many who have given little consideration to the remarkable development of trust companies throughout the United States in the past ten years. The trust companies, being state institutions, have no federal department to which they are obliged to make annual reports, and therefore statistics as to the number in existence, their capital, surplus, undivided profits, deposits, and total resources, are not as accurately collected as in the national banking system. The following quotation, however, from the report of the Secretary of the Treasury to Congress last December shows that the growth of the trust companies during the past few years has greatly exceeded in percentage the increase of national banks of the United States. The Secretary states:

Within the last few years trust companies have made a relatively much larger growth in all the large cities than national banks. There were twenty-seven trust companies and forty-nine national banks in New York City ten years ago. The same city now has forty-seven trust companies and only forty-one national banks. Ten years ago the aggregate capitalization of the New York City trust companies was \$26,400,000, and of national banks \$50,700,000. Now the trust companies are capitalized at \$54,900,000 and the national banks at \$110,300,000, showing about the same relative increase. But the difference in the growth of deposits is marked. Trust companies in New York City held less than \$260,000,000 ten years ago, and they now hold more than \$875,000,000, while deposits in national banks have increased from more than \$550,000,000 to a fraction less than \$1,100,000,000. Thus, trust-company deposits show an aggregate growth of \$65,000,000 more than national-bank deposits, and a growth of 240 per cent. as against 100 per cent. in national banks.

In Chicago the number of trust companies has increased in ten years from eight to twelve, while the number of national banks has decreased from twenty-one to twelve. The capitalization of trust companies in Chicago in the same period has increased from $4,000,000 to $20,000,000, or 400 per cent. as against an increase of 25 per cent. in the capitalization of national banks. Deposits in these trust companies have increased from $15,000,000 to $230,-000,000 in ten years, and in national banks from $130,000,000 to $280,000,000, or an aggregate increase of $215,000,000 in trust companies as against $150,-000,000 in national banks, and an increase of 1,400 per cent. in trust companies as against 115 per cent. in national banks.

Other large cities exhibit similar conditions. Many trust companies hold commercial accounts and are regularly engaged in discounting paper, and they hold in the aggregate more than $2,000,000,000 in deposits.

It should be borne in mind that, although the report of Secretary Shaw to Congress was made in December, 1904, the statistics above quoted are for the fiscal year ending June 30, 1904. In no year in the past decade has the growth been more marvelous in the strength and development of the trust companies than during the past twelve months, and the most accurate data obtainable at this time will show that there are 1,438 trust companies in existence, 278 of which were organized since June 30, 1904. In addition to the above, at least 400 companies employ the title of "trust company" which are not properly institutions of this character.

Few realize the financial development of the Middle West, and especially its financial center, the city of St. Louis. The aggregate capitalization of the banks and trust companies of St. Louis on June 1, 1905, was more than the aggregate capital of the national banks and trust companies of New York City ten years ago. It equals the capitalization of all the banks and trust companies of Chicago, and is practically equal to that of Boston.

According to the latest statistics, the banking power of the world is $33,608,000,000, of which $13,826,000,000 is represented by United States banks. The resources of the trust companies of the United States aggregate more than $3,250,000,000, which is over 23 per cent. of the banking power of the United States, and practically 10 per cent. of the banking power of the world. Secretary Shaw's suggestion in his report to Congress is very timely, when he points out the importance of giving trust companies the privilege of incorporating under federal law. If such a law should be enacted, a requirement should be placed upon the trust companies

in the matter of reserves. The stronger their reserve, the greater their strength.

The ratio of increase of the banking power of the world in the last fourteen years is 110 per cent. The ratio of increase of the banking power of the United States in the past fourteen years is 168 per cent. The ratio of increase in individual deposits of the national banks in the past twelve years is 90 per cent. The ratio of increase in individual deposits of the trust companies of the United States in the last twelve years is 390 per cent., and the individual deposits of the trust companies on June 1, 1905, were within a few million dollars of the individual deposits of the national banks of the United States in 1892.

When one stops to consider that the trust companies of the United States in their combined resources represent more than 23 per cent. of the banking resources of the United States, and practically 10 per cent. of the banking resources of the world, the importance of the trust company to this government is forcefully impressed upon one's mind. It is within the past decade that the British consol, primarily on account of the war in South Africa, dropped not only below par, but as low as eighty-six cents on the dollar. Within the past six months Japan and Russia were obliged to sell their securities on a higher basis than 6 per cent. interest per annum. It may be—it is certainly within the realm of possibilities—that the financial requirements of this government as a nation, through war with some powerful foreign government, may tax the resources, not only of the government itself, but of all its financial institutions to the fullest extent. Great Britain, France, Germany, Russia, Japan, China, and the United States have all gone through such periods within the recollection of everyone present. Should such a misfortune befall us in the next ten, twenty, thirty, or forty years, will not the government need the assistance of what is to-day over 23 per cent. of the banking power of this country, and what is destined to be one of its strongest financial factors? The interest-bearing debt of the United States government is less than $900,000,000. Its securities are rated the highest of any nation in the world; the government does not need the assistance of the trust companies at this time. Yet it is only a few decades ago when the debt exceeded $2,700,000,000, and the securi-

ties of the government sold at less than fifty cents on the dollar. The interest-bearing debt of New York City to-day exceeds $460,000,000—more than one-half of the interest-bearing debt of the United States. The City of New York needs the trust company to-day to assimilate its securities in order that they may sell their 3½ per cent. bonds at a premium.

The live, active, energetic banker, be he state or national, in all the large centers of this country, has recognized the value of trust companies for the accumulation of idle money, for the development of commerce, and for the enlargement of the financial horizon of the United States of America. Many of the larger national banks are financially interested in trust companies in the larger centers; some of the more progressive have organized trust companies and are running them in connection with their national banks practically as departments. It is only a very short period of time until the trust-company official, keeping pace with the procession of the national-bank official, will add a national bank practically as a department to the trust company.

In the western country, at least, the trust company occupies the same relation to the masses of the people that the savings bank does to the East. Very few western states have savings banks, the reason being that the trust company in the western states runs a department for savings, and such a department is in itself a savings bank of and for the people, where the thrifty son of toil may deposit his dollar a day, week, month, or year, and receive thereon interest varying from 3 to 4 per cent., with the entire capital, surplus, and undivided profits of the trust company to protect him against loss.

The trust company should not only keep a reserve, but a strong reserve. While it was well enough years ago, when the trust companies simply discharged the functions of trustee, registrar, executor, and administrator, for them to keep a nominal amount of cash on hand, with a comparatively small amount on deposit with banks, that condition has now ceased to exist, and is so recognized to-day. The methods applied to trust companies ten, fifteen, or twenty years ago are not applicable to-day, nor are trust companies doing business on the lines established ten, fifteen, or twenty years ago. If you will show me the trust company to-day which keeps

a reserve both in cash and in bank in comparison with the successful national banker, I will show you the trust company that not only pays its stockholders a handsome return, but that is constantly developing its business. The surest way to retard the growth of a trust company is to decrease its reserve. The most certain way to develop its resources and power is to increase its reserves.

Well-balanced trust-company officials invite publicity and frequent examinations, not only by the company's auditing committee, but by expert accountants as well. The trust-company official who fears frequent publication of the condition of his institution, and who does not encourage frequent examination of his work and the assets of his corporation, is unjust to himself, his associates, and his corporation.

The interest of the national and state banks and the trust companies are reciprocal. Examine the bank statistics of any financial center in the East, West, North or South, and where you find a great development of financial resources, there you will find the trust company not only doing its part for the development of that particular section, but also paying handsome returns to its stockholders upon the capital invested. The national and state bankers, where they are progressive, although competitors, are all working along the same lines. Of the $4,500,000,000 of deposits carried by the national banking system, practically 10 per cent. of the entire amount are the deposits of trust companies. The most cordial relations should always exist between banks and trust-company officials. Continue to encourage it as you have by this meeting in joint session; each will be greatly benefited, and the interest of both the bank and the trust company greatly advanced.

NATIONAL BANKS AND THE TRUST COMPANY PROBLEM

ADDRESS DELIVERED BY EUGENE E. PRUSSING, OF PRUSSING, BROWN & KING, CHICAGO, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW YORK, SEPTEMBER, 1904.

THE purpose of this paper is briefly to consider the situation which has arisen in the last fifteen years, though it has only recently become acute in its manifestations, and which has been not inaptly, though not quite accurately, called the "trust-company problem." It is considered safe to assume in this audience not only the existence, but also the importance, of the problem. The first consideration is to define its character; the second is to learn its cause and history; and the third and last, to suggest a possible remedy.

Broadly speaking, it may be defined to be the anomalous condition of affairs which permits the existence in the same community, side by side, of two classes of banking institutions, competing for practically the same business—namely, deposits—one of which is quite strictly limited in respect to its investments and guarded by definite requirements in respect to its cash reserve, while the other is practically free from both these wholesome restraints. These two competing classes are the national banks, organized under the National Banking Act, on the one hand, and the state banks and trust companies, organized under state laws, on the other.

The situation is peculiar to this country; it does not, nor did it ever, exist in European countries; its essential characteristic is legal. The reason for its existence is to be found in our dual form of government, our separation of state and national affairs, and the questions of policy arising therefrom. The existence of the problem has little or nothing to do with the nature of the banking business. Technically speaking, from the standpoint of banking science, it is an accident.

Its immediate cause lies in the failure of the National Banking Act to give national banks power as broad as those given to the state banks and trust companies by the banking laws of the various states enacted in recent years, and commensurate with the modern requirements of the business. The National Banking Act provides for only commercial banks, which were the chief need of the public at the time of its enactment. Since its enactment new and

great public needs have arisen, which the national banks have not been able to meet.

The main point in the situation is this: State banks and trust companies generally are authorized to do a general banking business—that is to say, to receive deposits from and make loans to, commercial, savings, trust, and all other customers—while the national banks are confined to a limited banking business, and are authorized to make only commercial loans, and thus practically, though not legally, to receive only commercial deposits. All other deposits naturally tend to the state banks and trust companies.

Broadly speaking, state banks and trust companies are not regulated by law in their investments and loans, and there is practically no requirement as to their cash reserve, while the national banks are closely guarded by law in both respects. If the national banks as a class are to maintain their positions as the leaders in the business, something radical must be done with the legal situation thus created. The question is: How should this be done? The facts necessary to a consideration of the situation are these:

Our national banks are, legally speaking, the result of an exercise of the powers of the federal government with respect to war and the currency, for the purpose of aiding the government in the great operations involved in borrowing money for, and paying the expenses of, the War of the Rebellion. When they were created, their existence was regarded by many as temporary. Their continuance for forty years after the close of the war, in times of peace, is evidence of their value as instruments of commerce and their helpfulness in furthering the prosperity of the nation. The means they were to employ in aiding the government were to issue currency based upon the deposit of government bonds purchased by the banks, and to facilitate the sale of government bonds to the public. As an incident to this business they were authorized to receive deposits of money, but were authorized to loan money only upon, or in discount of, commercial paper and bills of exchange.

These limited powers have placed them at a disadvantage in modern days, when the demands of the public for savings banks, trust companies, and other financial agencies have largely increased the field of banking operations, so that to-day, instead of being far and away the leaders in financial affairs, they are struggling for

place and are obliged to ally themselves with institutions of the trust-company class to maintain a fair position with the leaders in the financial world.

The reason for this situation is not far to seek, and the remedy is an obvious one, but the difficulty in bringing the two together, and thus relieving what may become a public misfortune, may not be easy. Reforms of a financial character involving national legislation, though in merely administrative or other subordinate affairs, are very slow of enactment. They require a long campaign of education to arrive at an understanding on the part of even our legislators, for the subject is to most of them *terra incognita,* and the public has an undefined fear of anything the national banker wants.

That an expansion of the powers of national banks has become a necessity to the legitimate exercise of their functions as parts of the machinery of the national government should require no long argument. A statement of the present powers of national banks, coupled with a short historical review of the development of the general banking business, which has resulted from the needs of our government and people since national banks were first established, will easily demonstrate the fact, and should arouse a demand that the undisputed powers of the national government should be exercised to give its sanction to the grant of further authority to these institutions, commensurate with modern requirements.

The refunding operations after the war justified the continuation of the national banking system when the first charters began to expire in 1884, and a renewal of charters was granted. Since then these institutions have become so thoroughly a part of the government machinery and a necessity to the public that their abandonment would be regarded as a long step backward.

The science of banking at the time of the establishment of national banks was at a very low ebb. It had not progressed very far in this country at any time, though the subject of much political contention and legislative action. The panic of 1875 and the breaking up of commercial relations with the South at the beginning of the war, with the consequent great losses to all engaged in commercial pursuits, especially banking, had reduced the number of banks and their operations to an almost irreducible minimum.

The financial needs of the country were being served by a comparatively few survivors of the commercial state banks, the New England and New York savings banks and their imitators in some of the other states, private bankers of various kinds, and a very few, perhaps six, trust companies.

The needs of the country during and immediately following the war, the profitable privileges conferred upon the national banks, the patriotic sentiments which both inspired, the successful management of these banks, and their careful supervision by the national government, in spite of a number of disastrous failures among the banks, created public confidence, and naturally resulted in the growth of the national banking system, until it became the chief financial element of the country; and until 1890 it was without a serious competitor in its leadership in financial affairs.

In the early eighties, the United States had, financially speaking, recovered from the disastrous effects of the war, and the panic of 1873; we were rapidly paying off the national debt, and the people were accumulating a surplus. The need of investment for this surplus, which no longer found lodgment in government securities, created a demand for proper agencies, especially in the East and Middle West, and the limitations then as now existing upon the powers of national banks turned the thoughts of enterprising persons into other channels.

State banks had been almost wholly abandoned, because their profitable feature of issuing bank-notes had been taxed out of existence by the National Banking Act. A few exceptions in some of the states, notably Illinois, maintained their existence chiefly as savings banks, or, if engaged in commercial business, were sustained by reason of the extraordinary character of their stockholders or officers or both.

In New England and the middle eastern states savings banks of an especial type had grown up, and, besides these and the national banks, perhaps a dozen of institutions known as trust companies had been established under state charters, and in nearly every instance had flourished. These trust companies were really banking institutions. The name "trust company" did not truly describe the chief part of their business; they received deposits, which they mixed with their own funds, and for which they became bankers

and not trustees. These deposits, however, were then of a peculiar character in two respects—viz., they were not payable on demand and they bore interest. They were usually taken upon certificates of deposit, payable generally upon short notice, or at a time stated, not exceeding one year, and bore a rate of interest varying from 2 to 6 per cent., usually less than 4. Such deposits, while not unknown in the national banks, were exceptional in them and were not encouraged, as they involved payment of interest, and the payment of interest to ordinary customers was then considered bad banking.

The trust companies, however, solicited these deposits from that increasing class of the community of recent growth known as investors, and naturally, as their business to begin with was limited, looked also to other business for support and profit. In lieu of the patriotic element with which the national banks were invested, the trust company had received another, but also very worthy, characteristic. The father of the trust company selected the agency legally known as the fiduciary trust as one of the chief elements of his creature's composition, and impressed its sacred name upon his child—a most happy and successful thought. The administration of trusts by trust companies is, in fact, not essentially different from, and no more important than, the execution of ordinary financial agencies by other banks throughout the financial world, but the character given to this particular class of agencies by its legal derivation, the sanctity with which it has been enveloped by judicial and legislative action, as well as the popular imagination, make it a highly valuable trade-mark. Nevertheless, we all know that the agency involved in making an ordinary investment for an inexperienced man or woman is no less serious and should be regarded as no less sacred. The public appreciation of this trade-mark, however, in the case of the dozen trust companies referred to, was sufficient to favor them with very considerable patronage and to make several of them, particularly in New York and Philadelphia, leaders in deposit lines, so that bankers generally began to consider them desirable adjuncts to the financial scheme.

The trust companies in question were all acting under special state charters, much alike in their chief features, but differing in details. They were not all incorporated exclusively for trust or

banking purposes, but included fidelity and other insurance and like business, not of the banking type, in some instances. In 1884, except in the states of Minnesota and Pennsylvania, no general law existed in any of the United States under which the incorporation of trust companies was possible, and there was as yet but little demand for them.

A suggestion made in October, 1884, by the writer, to the president of a Chicago bank engaged in a savings and commercial business under a state charter, and having the power to accept and execute trusts, which it did not use, resulted in a conference on the subject, in which it appeared that the chief difficulty in the administration of trusts lay in the necessity of giving a separate bond, with sureties, in court, in each estate. This requirement was a great burden, tedious in its delays and multiplicity, and impractical in the length of time the bond lasted, especially in guardianship cases. The Illinois constitution forbids special laws, so it was suggested that an act of the legislature, general in its character, applicable to all companies which then had or might thereafter have the power to accept and execute trusts, could remedy this difficulty by substituting, in lieu of the objectionable special bonds, a sufficient deposit of securities with the state for the benefit of all trusts accepted by the depositing trust company, and further providing for regulation, examination, and visitation of the trust companies by the state and the courts, as well as requiring reports by the trust companies.

The result was the preparation of a bill for "An Act to Provide for and Regulate the Administration of Trusts by Trust Companies," which was submitted to the Legislature of Illinois in January, 1885, but failed of enactment in the long deadlock of that year in the senatorial contest between General John A. Logan and Mr. William R. Morrison. The bill and its purposes were very thoroughly advertised, however, and attracted widespread attention throughout the country. In January, 1887, the bill was again presented to the legislature, and in June, 1887, an act was passed accordingly, from which, however, part of the powers desired were omitted, but in which the principle involved was fully established, and all details of security and examination were settled. In 1887, also, New York passed a similar general law for the establishment

of trust companies, as the result of the Illinois agitation in 1885. In 1889 Illinois completed its law by amendment granting the powers omitted in 1887. The Illinois act has been in force ever since, except for slight amendments intended to extend its benefits. Repeated attacks upon the act by designing persons in the legislature and the courts have only served to make many of those who first were honorably opposed to it in principle or in policy, its warmest defenders. The courts are its chief supporters.

The Illinois Banking Act of 1889, passed in connection with the second branch of the Trust Company Act, enabled all state banks to accept and execute trusts. This greatly stimulated the business. From these beginnings the wave has spread across the country, until now only ten states in the Union are without laws to create and regulate trust companies, and the United States government has accepted the principle involved by enacting a similar statute applicable to the District of Columbia.

The establishment of numerous trust companies, which promptly followed the enactment of these laws, the leadership of Mr. Stewart, of the United States Trust Company, in the refunding and other financial operations of the government during Mr. Cleveland's second term, and the usefulness of the trust companies and sundry private banking-houses employing trust-company methods in these and other great financial operations after the panic of 1893, soon evidenced the value and profitable character of these institutions and rapidly increased the public appreciation.

The multiplication of trust companies and their competition with private and national banks, which necessarily resulted, induced the early abandonment of the certificate-of-deposit plan as the sole method of receiving funds in trust companies. Deposits were soon received by nearly all trust companies subject to check, while interest was paid by them on daily balances in the European fashion, so that many national banks and other commercial banks have been forced to follow their example in that respect. The public demand for interest on deposits, and for these broader financial agencies under state sanction, has caused the establishment of many and such powerful institutions of the new type, until to-day the state banks with trust-company powers have become at least equally important factors compared with national banks.

In that connection I may be pardoned if I step aside a moment to illustrate by an anecdote the main point in the so-called trust-company problem. When I came to New York in 1884 to examine the subject of trust companies, in the preparation of the bill which afterward became the Illinois law, Mr. Stewart, the president of the United States Trust Company, gave me the most kind and useful assistance. In the course of my investigation I questioned him rather closely respecting fees and charges for services in the execution of trusts. After giving me many details, he summed up the subject by saying: "Don't bother too much about fees and charges; never let them control. Get the business. What you want is not fees, but deposits."

And so the situation is this: The trust companies have changed from depositaries of funds for or awaiting investment into general banks of deposits and discount, paying interest on balances and doing all kinds of financial business. They are the keen and successful competitors, not only of the savings and national banks on the one hand, whose powers are limited by law, and who are subject to certain requirements which the law properly imposes on them, but not on trust companies, but also, on the other hand, of the private bankers, against whom they are aided by that legal characteristic, "incorporation," which the trust companies possess and which is denied the latter.

It certainly behooves the national banker, therefore, to look about him to consider this situation and map out a future course. The banking business of the United States has grown in the last twenty-five years, not so that it disputes with the older communities of Europe the leadership in the world's finance, as our newspapers would have us believe at times, but so that it is in the front line and has need of all modern machinery in its institutions, and the time has come for the expansion of the powers of national banks, unless they are to fall behind in the world's march of progress. The patriotic and commercial values of these institutions forbid such a thought, and, therefore, let us examine their needs and try to supply them. National banks now have power to receive all kinds of deposits—commercial, savings, trust, and public. Their powers to use them are limited, they can only buy and sell securities, loan upon commercial paper, or discount bills

of exchange. Short-time or demand loans upon securities are permitted by judicial construction; but long loans, no matter how well secured, loans upon real estate, and the acceptance and execution of trusts, are denied them. The present provisions of the law in respect to their reserves are intended only for commercial deposits, are unsuited to savings, time, and other more or less permanent deposits, and necessarily prevent their profitable use. The result has been that such deposits go elsewhere, and the national banks are forced, in seeking the benefit of such deposits, to purchase stock in trust companies, participate in savings banks, or by the creation of special trust companies and savings banks openly advertised as filial or allied institutions, to supply themselves with these adjuncts to their business, while investment and bond departments have furnished the means for some of the operations formerly performed by private bankers only.

These devices are not only in many instances inconvenient and even undignified, but they have sometimes proved disastrous. They are unnecessarily expensive as well. The extra expense which results from this condition of affairs in the practical duplication of officers, clerks, and offices, and other items, is so large and so obvious that this alone, in this era of consolidation of business and centralization of management, should be a strong factor in favor of any change proposed. I am aware that in some instances a solution of this part of the problem has been very practically attempted by making the directors and officers of the national bank also directors and officers of its allied trust and savings bank. These and kindred devices tend to a disregard of the law of the land, which cannot be without detriment to all.

The situation calls for prompt and radical treatment, if grave results are to be averted. The dangerous conditions experienced in this and other large cities in the past two and a half years in banking circles were very largely attributable to this condition of affairs. It is possible that proper regulation of the investments and reserves of state banks and trust companies under state laws can be achieved, but in the conflicting interests involved there is little hope of harmony of ideas or successful effort to protect the public at present. The national banks, now at a disadvantage as carefully regulated and inspected competitors, must, I think,

seek some other legal remedy, or must continue to bear a large share of the burden and dangers of the situation.

It is with great hesitancy that I suggest at least a partial remedy in the expansion of the National Banking Act, so as to cover modern conditions. If it were so amended as to permit, not only the acceptance of all kinds of deposits and banking business, including the administration of trusts, with corresponding power to make not only commercial, but also time and real-estate loans, and long investments of savings deposits—all under proper regulations and in due proportions to the deposits received; with such further regulations as to cash reserves and reserve agencies as the different classes of deposits suggest and properly require, much would be accomplished in the right direction, by placing the national banks on an equal footing with the state banks and trust companies as to the power to do business, and giving the national banks the great advantage of proper legal restrictions and regulation. The amendment regulating investments and reserves would be comparatively simple matters, for we have many precedents in experience and in existing laws of various kinds.

The power to accept and execute trusts may require much careful hedging. It might be conditioned upon a compliance with the laws on the subject in force in the state in which the banks are located, or upon such special requirements as to amount of capital and the deposit of security with the Comptroller as are now contained in the act of Congress authorizing trust companies in the District of Columbia. These and other details may be left to future consideration.

The questions of policy and conflicts of interest which these considerations suggest are necessarily involved in what is apparent to us all, and must be met and solved sooner or later. It is not the purpose of this paper to do more than call attention to them. This organization should be the leader in meeting this situation, and in organizing a patient, careful, and scientific investigation of the subject, which will go far to produce a proper remedy.

TRUST COMPANY FAILURES

ADDRESS DELIVERED BY A. A. JACKSON, VICE-PRESIDENT OF THE GIRARD TRUST COMPANY OF PHILADELPHIA, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW YORK CITY, SEPTEMBER, 1904.

THE fact that there is no central bureau for the filing of statistics relating to trust companies, such as exists for national banks, which are under federal control and subject to the duty of making periodical reports to the government at Washington, renders it a matter of some difficulty to obtain reliable data as to trust companies throughout the United States. This is perhaps the more apparent in connection with any search for data relating to failures among these institutions, for while due diligence will collect a mass of figures relating to live corporations, those of companies that have suffered insolvency and passed their present activity are to be gained in many instances only from persons who were identified with them in their management or liquidation. It is only within comparatively recent years, as the assets of the class of corporations that we represent have assumed steadily increasing proportions of great magnitude, that the legislatures of the various states now having banking departments have enacted laws providing for officials whose duty it is to examine periodically the condition of trust companies to ascertain that they are being managed in accordance with the existing statutes. Even now some states have no such provisions, and although for the purposes of preparing some figures for your consideration I have approached the executives of all the states in the Union, this fact has somewhat handicapped me and rendered it necessary that for the purposes of making the data as complete as possible I should in some instances have recourse to unofficial figures for my calculations. Indeed I think that I have trespassed somewhat upon the good nature of my correspondents in this matter, but their uniform courtesy has possessed me of details of a scope beyond which I could not well go without becoming a nuisance to those to whom I have necessarily applied for information.

Trust companies of course had their birth in the older states. New York granting the first charter to the Farmers Loan and Trust Company, then known as the Farmers Fire Insurance Company, in the year 1822, and in 1830 to the New York Life Insu-

rance and Trust Company; while Pennsylvania in February of 1836 granted to the Pennsylvania Company for Insurances on Lives and Granting Annuities the powers to transact a trust business, it having formerly from its charter in 1812 transacted solely the business indicated by its title. In the next month of the same year, that is in March of 1836, the present Girard Trust Company was chartered under its then name of the Girard Life Insurance, Annuity and Trust Company of Philadelphia. These two states of New York and Pennsylvania practically monopolized the creation of trust companies until after the Civil War.

It may be proper before giving general figures to consider what failures have occurred in these states just mentioned, which have over sixty per cent. of the aggregate resources of the trust companies of the country, New York with $1,200,000,000 and Pennsylvania with $1,069,000,000.

The banking department of the state of New York was established in the year 1851, and in 1874 trust companies were placed generally under the supervision of the superintendent of banks. Mr. Kilburn, the present incumbent of this office, has very kindly provided me with figures showing that from the date of this supervision in 1874 to December 31, 1903, seventy-five trust companies have been incorporated, of which only two have failed: one in 1877 as a result of fraudulent management, and one in 1891 because of imprudent conduct by its officers. In each case the capital involved was one million dollars. These figures with which I am provided do not include those of companies that may have been temporarily in trouble, nor the unfortunate necessary reorganization under a new name of a company in the city whose short life was apparently devoted by its officers to the one end of floating securities in a manner that betrayed a lamentable lack of conservatism.

It would seem, therefore, that in the last fifteen years no company in the state of New York has actually failed to the extent of not being able to resume business, and although the company to whose failure I have referred as occurring in 1877 was a debtor to the total of seven per cent. of the aggregate assets of trust companies within the state of New York, we must remember that at that time, so closely following the depression of the panic of 1873, New York was possessed of very few trust companies, and a

failure of the size of the corporation which then became insolvent would naturally show a large percentage of the total assets then employed within the state. On the other hand, by the year 1891, when the second failure took place, the total assets of trust companies in the state had increased five and one-half times over the figure at which they were in 1877, and although the total liabilities of the insolvent company of the later year were $3,947,000, they form only ¼ of 10 per cent. of the total assets of trust companies in the state. Since that time, too—that is, in the last fifteen years—the aggregate assets of trust companies have increased above four and one-quarter times over the large totals of that day.

In Pennsylvania the banking department of the state was by law given supervision over trust companies in 1892. The records of this department show that there were deserved the laudatory phrases contained in the first report of the superintendent of banking upon the excellent condition in which he found the companies of the state. In 1892 a small concern that bore the word "trust" in its title, but was in reality transacting none of the business for which a trust company is properly organized, failed for a comparatively small sum. In 1895 another company with total liabilities of $105,000 made an assignment, the failure being 2-100 of 1 per cent. of the total assets in the banking and trust department of the Pennsylvania companies in that year. In 1896 a company that dealt almost exclusively in western mortgages assigned with total liabilities of $1,420,000, or about 2-10 of 1 per cent. of the aggregate assets of the companies of the state. In 1897 a receiver was appointed for another trust company which transacted materially the same kind of business, and found that its investments had so suffered by the bad years for farm lands in the West as to make it impossible for it to continue business. The failure of this company was also to an extent of only 2-10 of 1 per cent. of the aggregate resources of the companies in the state. In 1898 a trust company which was closely affiliated with a national bank for which a receiver had just been appointed, and to the president of which it had imprudently loaned money, found it necessary to make an assignment. This failure was a startling evidence of the evils of using one borrower as an outlet for money, and of the domination of one man or set of men in the directorate, while the other mem-

bers of the board were content to let the company be managed without devoting to its affairs the scrutiny that they should be bound give. It is, however, a gratification to know that although this company failed for over $2,000,000, it finally paid its creditors and stockholders in full. In 1901 a company that had not been formerly under the examination of the state department was placed in the hands of a receiver. Its total liabilities I do not know, but they were not of great aggregate.

There are no other failures of which I have knowledge within the state of Pennsylvania in the years during which the banking department has been in existence, save that of a very small company rejoicing in an illustrious and imposing name, and developing liabilities of $13,000; and another company, Pensylvanian in incorporation, but transacting no business other that that of having in its annual meetings within the borders of the state, its dealings being entirely in western mortgages.

From the foregoing it is gratifying to note that, taking as examples the two states which by their customs are perhaps more definitely engaged in what is the established practice of a trust company business, the ratio of failures to general assets has in no case amounted in New York within the last twenty-five years to more than one and four-tenths per cent., and in Pennsylvania in the last fifteen years to more than two-tenths of one per cent. I understand that in every instance the moneys and securities held by these corporations in fiduciary capacities, or, in other words, trust funds in the more literal acceptation of the term, were unimpaired by the difficulties experienced by the companies themselves. I may say that under the Pennsylvania statute and the laws of many of the eastern states, it is provided that trust funds shall be kept separate and apart from other assets of the company holding them.

Taking up now the broader field of trust companies throughout the country, I have arrived at the following results of my investigations:

In the New England states, the figures being official for all save Maine and Vermont, one company failed in 1891, three companies in 1893, one in 1896, one in 1897, and one in 1904. Those of 1896 and 1904 paid in full and resumed, and the others have paid their creditors from 38 per cent. to 55 per cent. The aggregate of all

three is less than ½ of 1 per cent. of the present assets of the companies in these states. As I am not provided with the assets of the companies in the several years in which occurred the failures, I cannot give the smaller percentage applicable to those years.

In the eastern states I have already read figures concerning New York and Pennsylvania. In New Jersey a company failed in 1890 with liabilities bearing a ratio of 1-10 of 10 per cent. to the total assets of the companies in the state in that year; and a company failed in 1903, whose nominal liabilities amounted to 2-6 of 10 per cent. of the total assets of that year, but this was a corporation that had a life of but a few months before it was convicted of practices at variance with reputable trust company methods, and its charter was surrendered. In Delaware likewise a failure occurred in 1903 of a company holding a charter under the laws of that state, but which was virtually a Mexican corporation with branches in different parts of the United States, and engaged in business which was foreign to a trust company in our acceptance of the term. We remember very well the failures of last year in Baltimore of two companies, and a third which was a branch of the Delaware corporation of which I have just spoken; and if we place the liabilities of these companies against the total assets in the state of Maryland we shall find that they amount to 20 per cent. of them. Investments of large sums in one asset was the primary cause of these failures, but one of the companies came out of the hands of its receiver and resumed operations a little over two months after its suspension with capital unimpaired, and the other a larger corporation, has disposed of the interest which had carried it to the wall, and I understand that there is every likelihood of a settlement in full with its depositors and creditors.

Even aggregating all failures in the eastern states within the lives of the several banking departments, the total liabilities form but one per cent. of the present assets within these states.

Of the southern states, Virginia, West Virginia, Mississippi, and Louisiana are the only ones furnishing me with official figures; in fact Georgia, Mississippi, and Tennessee have no banking departments with supervision over trust companies. From none of these states, however, am I advised that there have been any failures,

and the companies within their borders have between them assets of about $82,000,000.

From the state departments of the middle states I have received official figures from all but Ohio, Wisconsin, and Iowa. No failures are shown except one of this year in Indiana, where the company has paid its creditors in full; and one in Minnesota in 1903, with liabilities of $412,000, forming less than one-tenth of one per cent. of the assets of the middle states.

The western states, because of the absence of laws governing trust companies, or the recent enactment of them, have been rather barren as to figures in connection with my investigations. North Dakota, Kansas, Wyoming, and New Mexico report no failures, and I am not advised of any in the other states.

The Pacific states also, either by reason of lack of records in their governments or for other causes, have not furnished information as to any failures, and I am happy to say that I know of none.

The data at my command do not include the total assets of trust companies in the United States for the several years prior to 1903, but basing a calculation upon the figures of 1893 and averaging the growth of companies during the succeeding ten years, it would seem that the average ratio of the liabilities of failed companies throughout the country to the total average assets of all the companies has been approximately 9-100 of 1 per cent.

It is rather interesting to note that while one thousand trust companies in the United States have aggregate resources of $3,600,000,000, and the above result is obtained as to failures, the average ratio of liabilities of failed national banks to the total assets of national banks in the country during the same period—the last ten years—has been 28-100 of 1 per cent. From the last of the reports of the Comptroller of the Currency, from which I have compiled this result, I find that there are five thousand and forty-two national banks with total resources of $6,300,000,000, or more than five times the number of trust companies with less than double the assets.

Failures among us, therefore, seem to be reduced to a minimum. They would seem to have been brought about by imprudent management, depreciation of securities, and excessive loans to clients; while in only one instance has there been assigned as a cause of

insolvency the defalcation of an officer. The thing, therefore, that would be most hard to guard against is palpably absent from the list of misfortunes, and this is a tribute to the class of men that guide our companies. That the people realize their solidity is shown by the enormous bulk of their deposits, and that they are profitably managed for their stockholders is evidenced by the fact that from the compilation I have made of the dividends paid by six hundred and two companies that have been in existence for over two years, it would seem that their stockholders receive an average rate of 9.4 of 10 per cent. upon par of their shares. This exceeds the rate of 8.7 of 10 per cent. which is given in the Comptroller of the currency's report as the return to stockholders of National banks in the country.

THE BUSINESS IN FOREIGN COUNTRIES ANALOGOUS TO THAT OF TRUST COMPANIES IN THE UNITED STATES

ADDRESS DELIVERED BY HON. CHARLES FRANCIS PHILLIPS, PRESIDENT OF THE CORPORATION TRUST COMPANY OF DELAWARE, NEW YORK, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT MILWAUKEE, OCTOBER, 1901.

THE subject upon which I am asked to speak is one abounding in interest, and concerning which a great deal may be said that is eminently suggestive and practically useful; but it cannot be treated in precisely the way in which a casual observation of its title in the program would lead one to expect.

As a matter of fact, and in the strict sense of the term, there are no trust companies in Europe or the Orient, and none in the Latin-American countries, barring the Mexican Trust Company, a purely American foundation, and one or two others, all in a nascent state; nor, so far as I am aware, have corporations, any where outside of the United States and some portions of Canada, yet undertaken to do, in a conjoint and aggregate form, any substantial portion of the work which is customarily and regularly performed by trust companies among us. Indeed, the ideas underlying corporate fiduciaryship are the product of our special development, at once vigorous, rapid and intelligent, in the realms of industry,

commerce, and finance; though the source whence these ideas have drawn their inspiration may be easily discovered, not only in the teaching, but also in the practice, of the financiers of the Latin race, to whose superb gift of analysis and co-ordination, and to whose profound knowledge of basic principles, the modern business world of both hemispheres is indebted for its best theories and its most successful methods of exploitation and management.

But, if actual conditions make it impossible to institute direct comparisons, it is easy, and let us hope that it may be somewhat profitable, to observe in what way the functions analogous to those of American trust companies are performed in the older world.

And here, on the very threshold of our subject, it becomes necessary to remark that long centuries of sincere and enthusiastic devotion to the principle of concentrated, as opposed to divided or collective, authority, and the sentiment, sustained as well by habit as by tradition, of respect for personal prominence and ability and of confidence in the leadership of the specially trained and experienced few, have operated, in substantially every part of Europe, to cast upon chosen individuals those duties and responsibilities which, more and more each day, become, within our own confines, the prerogative of associated effort and of combined obligation. Even in England, which has given us, along with our language, so large a part of our laws and customs and so many of the components of our national character, the individual trustee is in such esteem as to make the success of corporate trusteeship on a very large scale, at least for the immediate present, extremely doubtful. You all remember, I fancy, the effort made by J. Spencer Balfour, about the year 1885, to turn to account through the Trustees, Executors and Securities Company, the idea which finds so ample and so profitable an expression in many of the financial institutions of our great cities; and, doubtless, you remember quite as well the absolute failure of that company to realize its purpose, outside the field of simple promotion. For a while it promised exceedingly much under the auspices of those who had created it, and its founders' shares, whose par value was only ten pounds, were sold, when they could be bought at all, for the enormous sum of eight thousand pounds; but lack of achievement, enforced modification of plan, and complete reorganization followed only too soon.

In England, and, generally speaking, throughout British territory, great enterprises are sustained far more largely than here by credit, independently of direct security; and in all those sections of the world the moral risk of an undertaking, which has always to do with its promoters and managers, and the inherent merit of the scheme itself, as a basis of development or improvement, are more closely scanned and more seriously weighed than the possible lien of the values emitted. Hence, English railroad and other industrial mortgages, which, if they were very numerous, would suggest the formation of trust companies on the American plan, are scarce commodities in the market; various sorts of debentures and preference shares taking their place, in obedience to the instinctive belief of the business community that personal worth and responsibility, coupled with thorough knowledge and wide experience, are, as elements of protection, superior to material and legal guarantees in the shape of fixed encumbrances. It may therefore be said that the trust companies of the British Empire are, in effect, its men of character, skill and wealth, whose names mean more to the investing public than liens of any sort. Much fiduciary work of a qualified character is, of course, done by the banks; but it is done as an incident to their general business, and not as a specific undertaking.

In judging the situation as it stands in relation to our Anglo-Saxon brethren, we must, however, remember that England, which is the soul of British finance all over the globe, is an ancient, a small, and a homogeneous country, with traditions that are, in many respects, more powerful than laws, and which has not to face, as this country has, the problems arising from the absorption of foreign peoples, the rapid increase of population, the restless aspirations of the multitude, the ceaseless development of a practically unlimited home territory, the incessant creation of new enterprises, and the important political isues which are inseparable from the freshly assumed responsibilities of a world power. Hence, although everywhere and always it is the individual mind, moved by providential vocation, that guides human destinies, whether they be material or moral, and however they may be influenced by what we call general conditions, it is nevertheless true that in this country, largely dominated as it is by the direct action of the masses, the aggregate man and the aggregate form of effort have a prominence

which they nowhere else enjoy, whether in the domain of government or in that of economics. Other countries may, sooner or later, find it advantageous to imitate many of our institutions, and our trust companies among the rest; but the trust company as we know it here is likely to remain for a long while a distinctively American form of business facility.

It is true that a few of our greatest trust companies, as, for example, the Guarantee Trust Company of New York, have established branches in London and some other foreign cities; but the officers of these institutions assure me that the operations of their branches are, from necessity, confined mainly to the issue of letters of credit and to the purchase and sale of exchange and of current securities designed for investment. These transplanted financial models may, however, serve as educational factors, and so, in the long run, do a work for which they were not specifically or even consciously established. They have, in fact, helped to stimulate the creation, on a considerable scale, of safe deposit vaults and like conveniences; though they have failed thus far to give any noticeable impulse to the extension of fiduciary work through corporate mediumship.

As to the provision so necessary to be made, in an active community, for the care of long-time deposits, both the English and continental banks and similar institutions have, from time immemorial, done more than has ever been undertaken by either banks or trust companies in America, and have done it more broadly, more efficiently, more cheaply and more satisfactorily, thus furnishing us with precedents eminently worthy of respectful study.

In Germany, Austria, and some other parts of continental Europe there exist, in great numbers, what are called mortgage banks, institutions created to aid agriculture, which must always need considerable funds for uncertain periods, and to promote the interests of rural and urban land owners, large and small; and these banks, which subsist on their own capital and on deposits received under special conditions and paying a fair return, undertake, to a certain extent, some classes of work which are commonly assumed by trust companies here, such as the receipt, exchange, and distribution of securities in cases of organization, reorganization, and consolidation; but their fiduciary activities are neither numerous nor of

broad application. It is in France that we find more fully developed than anywhere else the idea of such intervention as here constitutes the most beneficent function of trust companies and kindred institutions; and, since the time allotted to this paper is necessarily very restricted, I shall ask you to permit me to confine myself almost entirely to a view of what French finance has achieved in the field which it is my present duty to explore hastily; it being premised that trusts arising out of the private relations of life, such as those of executor, administrator, guardian, committee in lunacy, and the like, are, in France and in other parts of continental Europe, even more than in Great Britain, relegated to the individual, and exercised by a limited class of persons, whose ability, knowledge, experience and probity mark them as pre-eminently qualified for tasks where delicate and sympathetic appreciation are often as essential to ultimate and thorough success as are business tact, efficient watchfulness, and careful legal procedure.

The rôle assigned in France, and in some other countries, to boards of trade, chambers of commerce, and other commercial and quasi governmental bodies, often renders not only inexpedient or unnecessary, but even impossible, certain trusts, which, among us, constantly arise from the exigencies of ordinary business, such as those relating to bankruptcy, receiverships and liquidations; and so it happens that what we have mainly to consider in the present case are those trusts, direct or implied, which spring from economic development, the alternate concentration and distribution of capital, and, in a particular sense, the regulation of credit, a thing even more vital in old than in new countries, in dense and highly organized communities than in those of relatively scant population and less complicated formation. And here it becomes imperative to remark that our own country, so justly esteemed the model of liberal and progressive government, the home of general and unstinted opportunity, and the friend of broad and vigorous initiative, has proved itself to be, in respect to the common financial needs of all who must work for a livelihood with either head or hands, the least democratic of the great civilized powers. To so large an extent is this true that one may safely assert that what is somewhat difficult of attainment here by men of tolerable substance is, in France, within the easy and constant reach of the most insignificant of

toilers. Let an ordinary workman apply to one of our large trust companies for a mortgage loan of three or four hundred dollars on his modest tenement, or let a petty tradesman seek to secure from it in permanency such accommodations as will enable him fully to develop his humble enterprise, and the truth of my statement will be quickly confirmed. The fact is that the whole machinery of higher finance in France, as represented by public institutions, forms a single trust company of unbounded responsibility, acting, in many respects, gratuitously for its beneficiaries, imprinting with its moral guarantee the bulk of all the securities which constitute the savings of the people and the reserve power of the nation, and, by its highly ramified operations and by the facilities and immunities which flow from them, making useless many of the forms of procedure which give rise to the work and assure the profits of the enterprising trust companies which are to be found in every quarter of our own land. This will scarcely be believed without illustration; but illustration is more than easy, and it is likely to be instructive.

One of the most conspicuous functions of our trust companies, apart from such as are technically fiduciary, is to gather together, whether through interest-bearing accounts, certificates of deposits, debentures, or otherwise, the long time funds of the community, and those which are not regularly needed in the quick turn-over of daily commerce, and to lend them, on the pledge of securities, on mortgage, or in some equally safe manner, to those who require cash for legitimate speculation, or who, in construction or development, or with a view to family settlements, must expend an amount of money which cannot be prudently withdrawn from business operations or obtained, without inconvenience or disadvantage, from the outright sale of real property or of special investments. This function is certainly a most useful one, and in the performance of it an immense volume of funds is wisely and beneficently employed; but whether the trust company discharging it be a small one, with two or three millions at its service, or a large one, commanding fifty or a hundred millions, or even more, the policy pursued is, with slight exceptions, always the same. Money is taken and lent in blocks of thousands; and the larger the blocks, consistently with the circumstances of the case and the prudent conduct of affairs,

the more completely the management is satisfied. Depositors and borrowers who deal in petty sums are respectfully referred to the savings banks and the building societies, admirable institutions in their way, but frequently cumbersome, and, in the scientific sense, always far from economical. But this is not the case in France, and there, as the result of a more direct and democratic policy, the corporations most analogous to our trust companies, such as the Société Générale, the Crédit Lyonnais and the Crédit Foncier, have obtained proportions so large as to make even the most prosperous of our trust companies, and of our banks as well, seem very small indeed.

Let us examine for a moment the methods of the Crédit Foncier, an institution eminently typical, which, alike in good times or bad, can easily furnish a hundred millions of dollars, at substantially a moment's notice, to any enterprise or series of enterprises deserving it, and whose mortgage loans amount to probably not less than five or six hundred millions of dollars, scattered all over France, in sums varying from a few hundred to several millions of francs. This institution has, of course, a very large capital, but one wholly inadequate to its immense operations. It has, however, so thoroughly proven its devotion to the common good by aiding the community in detail and the public as a body, and by offering, year in and year out, to even the humblest dealer the most favorable rate for his little deposit and the readiest succor in his small wants, that, when it needs money, as it often does, it can obtain it in unlimited supply by the mere issue of its long time debentures on no other security than its own reputation, and thus stand prepared to advance the funds which build up enterprises that must be slowly developed, or to respond to the never ceasing demands of the great army of workers whose systematic industry and thrift, thus supplied with capital, have made France, in a broad sense, and in proportion to its population, the richest country in the world, in spite of wars, a vast standing army, heavy taxes and occasional commercial catastrophes like that of the Panama Canal.

The securities which come to this institution in virtue of its co-operation in the upbuilding of prosperity, and which are, no matter what may be the prevailing conditions, scrutinized by it as carefully as the collateral of a time loan would be scrutinized by

us at a critical juncture, it sells to the great public, who, relying on its moral guarantee, not only buys in a single day the whole of each issue, but in the majority of cases tenders impatiently from five to twenty times the amount of the emission. Whoever, during a visit to Paris, has chanced to enter the Rue des Capucines, on an offering day of the Crédit Foncier, will recall very vividly the impression made upon him by an orderly crowd of ten or fifteen thousand men and women, of almost every class and condition, calmly waiting, hour after hour, in the hope of getting a small allotment of the day's securities, either for themselves or for those who depend upon them, and confiding in the institution which they know so well for that wise forethought and positive protection which widows and minors and *cestuis que trust* would here have a right to demand from the fiduciary corporations governed by ourselves and our associates. When there is question of borrowing instead of buying, the humblest city householder, or the remotest farmer owning a few hectares of land, is well aware that the highly perfected system of this wonderful institution will promptly secure for him the few thousand, or it may be only few hundred, francs he needs, and upon terms as good as can be got by the great proprietor who wishes to mortgage for millions of francs his vast factory, his luxurious hotel, or the wide demesne of his chateau. He probably does not know what a trust company means, but he knows perfectly well, in his own way, what a trust company is; for his knowledge is drawn from personal experience, and though the trust which operates in his favor is not a legal one, but is voluntarily assumed and administered without direct authorization, he sees that it gives to him the best of securities as an invesment for his savings, the highest price when he wishes to convert his holdings into cash, a constant market for whatever he must sell, a borrowing capacity which, in the measure of his wants, is as good and as certain as that of the richest banker, and, above all, that assurance of fair treatment and watchful interest which permits him to get not only what he wants, and when and where he wants it, but to discharge his obligations quickly or slowly as he may wish, and either in a single sum or by that kindly process of amortization through which the principle of a debt is paid whilst one seems to be paying only the interest.

When we approach other establishments than those of which the Crédit Foncier is the type, and enter a field where banking, in the ordinary sense, presents itself as the main feature, the same principles apply and the same facilities exist. Institutions like the Crédit Lyonnais and the Société Générale, in order to meet the wants of all, maintain not only great central bureaus in the principal cities, but numerous branches all over the land, as do many of the British banks, and deal as cheerfully and as courteously with a matter of a hundred francs as with one of a hundred thousand; each branch having all the facilities of the main office, and serving as an automatic and costless distributer of capital without those disturbances that are here incident to the compulsory flow of currency which occurs whenever the crops must be moved or some unusual condition be met at points distant from the financial centers. The incessant turnover of money in the hands of these institutions, its elasticity and fluidity under the system of management pursued, surpass anything to which we are accustomed in this country; for, practically speaking, except as against operations deemed to be unwise or dangerous, no honest borrower in town or country is ever refused what he may reasonably ask, be the times prosperous or trying. Of course, such facilities, covering so broadly the field here occupied in part by banks and in part by trusts companies, and administering absolutely without limit to the needs of all classes, and to active and continuous as well as to casual and incidental business, would not be possible if our methods were observed; for at times the resources of any one of the typical institutions I have named might be taxed to an extent which, under our system of management, would bring about either an abrupt curtailment of facilities or possible disaster. But in France even the largest financial institutions look upon rediscount and mutual accommodation as a most proper and advisable source of relief under all circumstances; and banks and similar establishments, whose capital, surplus, and deposits range from one or two hundred millions of dollars to twice as much, and which are, therefore, stronger than almost any of the banks of our country, and are certainly entitled to be jealous of their credit and standing, think nothing, at any time, of rediscounting their loans with each other or with the Bank of France to the extent of many millions of francs, thus giving to their

resources a liquidity and a responsiveness to passing conditions, the lack of which in our own system all of us have felt on many occasions. This solidarity of operation and of policy, coupled with the system which makes the credit of these institutions equal to cash for operations large and small, and throughout the whole country and all of its dependencies as thoroughly as in the heart of Paris, is a phase of economics demanding our most thoughtful attention.

But at the bottom of the whole fabric of France finance, so democratic in its character, and, in the commercial and industrial sense, exhibiting so largely an unsolicited fiduciary character, stands the Bank of France, itself the very essence of the spirit of which we have spoken. This bank, by all odds the most powerful in the world, and at the same time the most directly subservient to popular necessities, has never, even in the times of war or revolution, refused to administer to the honest requirements of the community; and yet, in spite of its liberality, its losses are always insignificant, never, so far as I have been able to learn, having risen as high as the one hundredth part of one per cent. of its operations, and being, of course, wholly lost to sight in the immense volume of its profits. The source of its security lies always in the unbounded aid given by it to legitimate business and in the confidence it thus inspires, being, in the last analysis and in virtue of its wise generosity, its own clearing house, and so being permitted to offset its obligations against its resources by the simplest processes of bookkeeping, without inconvenient dispersion of funds.

In the same way in which the Crédit Foncier has made itself a voluntary trustee for the long-time operations of the country, the Bank of France has, on its side, made itself a like trustee for the rapid operations of modern commerce, securing directly or indirectly to every worthy trader, however humble, constant and liberal credit, by encouraging the habit of replacing open accounts by acceptances, and thus making each man's bill-case, instead of his ledger, the stronghold of his business. It demands at least two names on every commercial bill, so as to secure the record of a legitimate transaction; but it will discount any good bill that is not less than forty francs, or eight dollars, and does as a matter of fact discount each day in the year, among the numberless trading

documents which pass through its hands, from twenty thousand to thirty thousand inland bills of exchange of which not one exceeds in amount a hundred francs, or twenty dollars. As to loans upon securities, where of course a single name suffices, it will accept any collateral that is essentially solid, whether it represents bonds of the state of Wisconsin, stocks of the city of New York, the obligations of a bank in China, the consols of England or Russia, or the rentes of France. It wishes to give to every Frenchman, so far as wisdom may permit, the facilities necessary for the prosecution of any legitimate business at home or abroad, and to do this in a manner affording the utmost ease consistent with ordinary prudence.

It may seem but little pertinent to my subject that I should speak in so marked a way of an institution which is pre-eminently a bank, and not a trust company; but I do so in order to explain how it happens that other institutions, which from their very nature must do much that is expected of trust companies here, can do it readily and always, and without risk or inconvenience. These other institutions know that in their hour of need they can, with the certainty of prompt response, apply to the Bank of France for any relief they may require, and that the bank itself is safe in granting such relief. But it is not alone its six hundred millions of dollars of metallic reserve, coupled with other resources just as boundless in their way, which give to the Bank of France its wonderful strength, important as its cash and securities are in the estimate of its influence. The secret of its power lies in the fact that it has made itself the trustee of the nation's credit, and that, by perfecting a system which secures instant accommodation on any scale, however large or however small, for every proper transaction of industry, commerce, or finance, it has become the reservoir of the nation's wealth and the adjuster of the nation's accounts, rarely making, or being expected to make, any other output of cash than that which constitutes the small change of the daily life of a great and energetic people.

We have much to learn from our colleagues abroad, and I believe that we are disposed to profit by our opportunities; though young and vigorous peoples, temporarily raised above the neces-

sity of close economy, are somewhat prone to believe their own judgment the best that exists.

Some years ago I laid before many of the ablest officers of our banks and trust companies all the ideas which are suggested in this paper and many more of a kindred nature, and offered, with their co-operation, to put them to a test, so far as circumstances might prudently allow; but although I everywhere got a respectful hearing, and sometimes a sympathetic one, I was told that my suggestions were in advance of the times. They may have been; but some of them have, from the sheer force of events, been since carried into effect, and others are daily presenting themselves directly to the consideration of able and experienced students of finance, and will not fail to command attention. Indeed, I am sure that the trend of modern civilization and the ever-growing unity of the human family, commercially as well as socially, will bring us, in respect to the work of both banks and trust companies, to adapt to our new and somewhat unique conditions the plans and expedients which have been envolved from the larger experience, the profounder thought, and, I repeat it advisedly, the more democratic financial procedure, of the older world—a world which, though it may have learned some lessons from us, has taught us, and has still to teach us, many more than we are likely to be able to offer to it for very many years to come.

INVESTIGATION AND AUDIT OF THE ACCOUNTS OF A TRUST COMPANY

ADDRESS DELIVERED BY A. O. KITTREDGE, C. P. A., OF NEW YORK, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW ORLEANS, NOVEMBER, 1902.

MODERN conditions demands regular and systematic investigation and report or audit in all divisions of business. The trust company, which, in the short time that it has been before the public, has been exempt from various rules, should be no exception in this regard.

Trust companies and banks are in the same general class, and in a sense the same business rules would apply to the two. Banks

are systematically examined or audited under provisions of the law, and while trust companies are occasionally examined by representatives of the banking departments of the different states under which they are organized, at the same time regular and complete audits are with them the exception rather than the rule.

Banks, upon the basis of natural selection and long experience, have reached what might be described as uniformity in accounting. That is, the features of their accounting systems are so much alike that the examination of one bank is a fair preliminary study for the examination of various other banks. On the other hand, trust companies are yet so new that in various directions their account-keeping is crude. Their methods, if not experimental, are yet in a condition not thoroughly worked out or reduced to definite form.

If any excuse were necessary for obtruding upon the attention of this assembly at this time some remarks about the investigation and audit of trust companies, the same is contained in the preceding remarks.

In every modern business venture or organization for business purposes, a very considerable part of the undertaking rests upon the basis of credit and upon the intelligence or care with which its managers conduct the business. Accordingly, in the prospectus of various trust companies, we find paraded at the head of the list from twenty to twenty-five men, who are the directors or trustees of the organization and whose high standing in the community is supposed to give credit to the company with which they are connected.

The public does not stop to think that at best a very small number of men stand for the actual transactions and policy of a company doing business. Such, however, is the case, and the trustees, high minded men as they very generally are, require the services of an expert examiner, from time to time, in order that they may know that those put in immediate charge of the affairs of the company are not mismanaging their trust. On the other hand, the stockholders and the public at large have rights likewise in this regard.

A trust company may be described as a corporation authorized by law to undertake every kind of trustee work, and, in addition to this, to do a general banking and financial business. A trust com-

pany has a wider business scope than a bank. While it can furnish its customers with every facility which the bank can supply, it can render them a great many services which the safest and best equipped bank in the country cannot. A bank cannot offer its customers the facilities which a trust company offers, because from the special character of its business and its close relation with trade, it has always been hedged around by law with restrictions deemed necessary in case of purely commercial undertakings. Trust companies exemplify enlarged banking powers adapted to the ever growing requirements of modern business. They do not compete with or usurp the places of banks, but in themselves use the banks, while with their transactions they go over and beyond anything for which banks were created.

The functions of a trust company are numerous and far reaching, comprising various matters from the management of estates to ordinary trusteeships, and from a banking department on the one hand to an underwriting syndicate on the other. They include, in addition to ordinary banking, the following powers among others: Acting as trustee under mortgages to secure bond issues; trustee for married women with respect to their separate property; guardian, receiver, or trustee of the estate of minors; executor or trustee under wills; committee of estates of lunatics, idiots, and persons of unsound mind; administrator, trustee, guardian, executor, receiver and assignee of insolvent estates, manager of estates of every kind during the temporary or permanent absence of the owners, or for persons advanced in years, or for persons wishing to place the care and management of their property in the hands of a capable agent; collection of rents, interest, dividends, etc.; acting as registrar and transfer agent of the capital stock and bonds of corporations; general agent for non-residents and invalids; general agent for foreign municipalities, corporations, etc., for the transaction of approved financial business; the general execution of legal trusts, and many others both general and special.

Trust companies exist under and by virtue of state laws. The laws in the several states do not agree, and some of them are more favorable to trust companies than others. All of them demand reports from the trust companies annually and in some cases more frequently. In most of the states there is provision for occasional

examination of trust companies by representatives of the state banking department.

The official bank examinations by national bank examiners throughout the country are frequently characterized as being insufficient and in many cases unsatisfactory. The pay allotted to bank examiners is notoriously small and the time in which the examination of a bank is ordinarily made is altogether too short. There is no basis of comparison between the examination of a bank as commonly conducted and that of a trust company as circumstances demand. There is an entirely different class of talent required in the examination of a trust company.

As with banks so with trust companies. We find different organizations doing different classes of business, and yet the range of difference with banks is very much less than the range of difference with trust companies. We find one trust company specially organized to take care of the financial interests of a certain clique of wealthy men, or to look after the investments of a certain circle of men. We find alongside of it another trust company doing the same thing for another set of men. While in the one case, railroads and street car lines may be the principal features, in the other it is industrial operations, including perhaps real estate matters. However we approach the subject, we find no two trust companies, speaking within limits, doing exactly the same kind of business. There is an individuality about each, and therefore we come back to the previous conclusion that the examination of a trust company must proceed upon original lines; that it cannot be based upon work done for other trust companies, or, rather, that it cannot be done after a general pattern supposed to fit other trust companies.

It would seem to be the opinion of some of those who are giving but brief consideration to the subject, that it is possible to devise a plan or scheme of trust company investigations and examination that is at once very simple in its elements and at the same time very comprehensive in its results. I have been urged to present on this occasion a blank that might be used by examiners of trust companies. As already stated, a single blank is inadequate. It does not begin to reach the case, and if we were to take any individual trust company, and in the light of complete knowledge of its affairs

prepare a blank or set of blanks by which its periodical examination should be conducted, we should find that this blank or set of blanks would not apply to any one of the numerous trust companies working side by side with that to which the first set of blanks was devoted.

The examiner of a trust company must become familiar with the different undertakings of the several departments of the company. He will approach each as a new proposition. He will bring to bear in his work all the experience that has accrued in the investigation of various industrial and mercantile operations, and he will proceed with his undertaking cautiously and ever with an eye looking out for the unexpected.

First will be the division of the trust company into its several departments. These are more or less numerous according to circumstances. Each of them is more or less developed, likewise, according to circumstances.

He first takes up, for example, the department devoted to individual trusts and the management of estates, including such matters as executorships and trusteeships under wills. In this division he must follow out each individual trust and examine it on the merits of the case and not from the standpoint of any fixed rule.

Next, for example, he takes up the question of administration, and in this department considers the company from the standpoint of administrator, trustee, guardian, receiver, or assignee, as the case may be. Here again each individual undertaking must be examined from beginning to end in order to put into the report that which he is expected to present.

Again he takes up the question of trusteeship under mortgages issued by corporations or municipalities. Here there is the inquiry along specific lines to be assured that the company is not making mistakes and is not abusing the confidence reposed in it. And so we might go through all the different divisions of a trust company's business, including membership in underwriting syndicates, guardianship, management of estates in the absence of owners, agencyship for the collection of interest, rents, etc., general financial agency, registrarship, etc.

Since a trust company's functions are so various and so numer-

ous, an examination into its affairs for the purpose of certifying as to its condition is other than a simple matter. No rule expressed in few words can be laid down for the purpose. No single blank or form will meet the exigencies of the case, but the examiner must patiently check up each of the several departments of the trust company and in each department follow out each of the several undertakings laboriously and patiently, until a definite conclusion is reached.

The examiner who approaches a trust company for the purpose of audit and investigation should know something of the origin and rise of these corporations in order to be in a position to judge of their operations. What is there about trust companies that enables them to enter a field to all appearances fully occupied, and in a period of less than a quarter of a century to succeed to the prominence which they at present hold?

This has been answered by one writer on the basis of the theory of natural selection. According to this writer, a gradual change in our financial conditions and the increase in our national wealth has led to corresponding changes in the structure of our monetary institutions, and has resulted in the formation of establishments suited to our changed environment, in the form, on the one hand, of trust companies with large capital and surplus to conserve, and on the other hand, of banks solidified and amplified by amalgamation in order to be better able to handle the growing volume of our enormous trade. It was inevitable that the great stream of our bankable wealth, which has enormously increased of late years, should sooner or later become divided in this way, in order to separate that portion which was actively engaged in trade from our invested capital; and the extraordinary development of the trust companies already formed and the new life infused into banking show how beneficial to both the change has been under the new classification and division.

The whole design of banking is to further and facilitate trading operations, in which, as a rule, two-thirds of its resources are directly employed in the form of discounts, and hence are unavailable for any other purpose. Trust companies, on the other hand, instead of using their capital for discounts of personal obligations, keep it in hand for other uses. Trust companies are not concerned

with trade risks. Accordingly, they are not shackled by restrictions imposed to guard against trade risks. The trust company of to-day, combining as it does every function of financial business, stands with respect to the financial world as the department store stands in the commercial world.

One or two general directions may be given in closing: What the examining auditor must do in order to prepare a complete report of the affairs of a trust company, can be determined by measuring the affairs of the trust company by a balance sheet and profit and loss statement. It is customary with trust companies, as well as with banks, to put forth from time to time a statement of their affairs. This statement approximates a balance sheet, but is not complete. On the other hand, a complete balance sheet, or the outline of a complete balance sheet, will give the standard by which the affairs of a trust company may be judged.

Let us consider just what these broad statements mean. The affairs of every trust company, as well as of every other business institution, are susceptible of statements in balance sheet form. What are the assets and what are the liabilities? Preliminary to any balance sheet statement must be the profit and loss statement. What are the expenses? What are the revenues? The profit and loss statement included with the balance sheet statement makes the latter complete.

At the outset, then, let the examiner lay down broadly the accounts that to him seem necessary to constitute a balance sheet of the business. A balance sheet can contain nothing but assets and liabilities What are the names of the accounts necessary to represent correctly the assets of the company? What are the names of the accounts necessary to show correctly the liabilities of the company?

In this analysis he must not be content with generalities, but instead must enter into details. The resulting statement will be very much more extensive than that in the form given to the public, and yet its footings will be identical with the footings of the published statement, provided, of course, that the latter is correct. It will not be sufficient to put down in this balance sheet, for example, so many bonds of such and such an issue and then close that division of the account by saying "Other Stock Investments." Instead,

the other stock investments must be laboriously and completely listed. It will not do to put down bonds and mortgages, but instead bonds and mortgages must be enumerated in detail. It will not do to put down other outstanding accounts. Instead these accounts should be completely and correctly listed. It will not do to put down cash on hand. Instead there should be shown so much cash in the vault, so much in this bank and so much in another bank, as the case may be. Again, on the liability side, it will not do to put down amount due depositors, without the preparation of a complete list of depositors showing in detail what makes up the total. And so we might go on through the entire list.

There are always matters pending in trust company affairs which among the assets should be covered by some such account as items in suspense. Insurance paid in advance, and various expenses which have been anticipated and which are to be pro rated out as the months pass by, should come under this head. Items in suspense is a very proper entry in every balance sheet, and yet there are comparatively few balance sheets which show it.

On the other hand, there are various accrued expenses which are not yet paid, but which should go on the liability side of the balance sheet under the head of reserves. Taxes have accrued upon a certain piece of property and yet are not due for three months to come. The accrued taxes to date should be placed under this head. Interest has accrued on money borrowed, but it is not payable for some time to come. In charging into expense the expenses which occur, reserve for interest should be credited. In turn, when it comes to the payment of interest the reserve account is debited. Again referring to suspense, the reserve interest charge is to be managed the same way.

The thought underlying this suggestion is that the auditor who sets out to establish a correct balance sheet of a trust company thereby has pointed out to him the direction in which his investigations should extend, whereby he becomes cognizant of all the facts of the company, and whereby he gets into a position to certify to the correctness of the statement he may prepare.

TRUST COMPANY FORMS

ADDRESS DELIVERED BY ARTHUR HEURTLEY, SECRETARY OF THE NORTHERN TRUST COMPANY OF CHICAGO, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT MILWAUKEE, OCTOBER, 1901.

THE first need of a trust company after it has been duly organized and has found a suitable location in which to transact its business, is to have suitable books and blanks for preserving the details of its transactions from day to day. The officers are usually men who have had some experience in bank work or in the practice of law, but have seldom had an opportunity to make any study of the forms of accounting suitable to the business of a trust company, and therefore have been obliged either to obtain assistance from older companions or to work out their own salvation as best they could.

At the last meeting of the section a committee was appointed to prepare a set of forms suitable for a trust company to use, and the result of their labors is now in the hands of many of our members.[1]

The prime requisite trust company forms should possess is simplicity. Too much stress cannot be laid upon this point. Many a blank book is made so complicated by rulings and headings as to mystify any one, except those who have been accustomed to using it constantly. Trust company forms should tell their story plainly; so plainly that any one of average intelligence can understand how they are to be used. Every book and form should be planned with reference to the entire system of accounting, so that the forms taken together will make a complete and harmonious whole. Through all the books there should run a chain of entries so made as to bind them together; cross references should be made, and every entry should show on each book or form whence it was derived. It should never require the services of a chartered accountant to check a proper system of trust accounting. The errors that will occasionally creep in should be found by an almost automatic operation of the system itself, combined with a careful checking of the entries each day. Every entry made on one book should be capable of being checked from at least one or two other books

[1] A large volume containing a careful selected collection of trust company forms was prepared and published by the American Bankers' Association, 1906.

kept by different clerks. If this plan is carefully followed up, combined with the proper custody of securities and cash, it seems to me that serious errors in the accounts as well as defalcations will be prevented.

The cash and securities should never be in the custody or control of the same clerks that keep the books; where it is practicable there should be double custody of all securities. In any event, a careful record should be made of every security, interest coupon, or valuable paper taken to or from the cash vault, and receipted for by the proper officer of clerk.

There is no particular mystery about accounts or bookkeeping generally. Given a good practical system of accounting with simple forms handled by clerks of reasonable intelligence, whose work is carefully watched by the officers, and whose efforts to improve the forms they use are met by proper encouragement, the result will be very satisfactory. Perhaps it will be of interest if I attempt to briefly discuss the principal forms to be used by a trust company.

The first book required is a register of trusts. When a trust is accepted by the company it should be entered upon this book, which should show the name of the trust, the filing number given it, the date of acceptance, source of appointment, the total amount of the estate or trust fund, the attorneys connected with the trust, etc., also the date it is finally closed. In short, the register should give a brief history of the trust, and it is of great utility as a book of ready reference. This book should have an index. At this point I desire to say, that in my opinion the plan of giving every trust a number by which it is known all through the records is a good one. It renders the correct filing of papers, etc., much more certain, and from practical experience I can safely recommend it. All papers referring to the trust should be filed under the number assigned it, and all securities belonging to the trust, and filed in the cash vault, should be placed under a similar number.

Next to the register of trusts come the cash book, the general journal, and the general ledger. The entries should be made first in these books; then from the same tickets the proper entries should be made in the trust journal and posted in the trust ledger. It is from the trust ledger that all statements of account should be made,

and the pages should be so ruled and arranged that the stenographer can take the book and copy the entries as made, the result being an account in proper form for filing in court or to send to the beneficiaries in the trust estate.

A stock and bond ledger should be kept, in which all the stocks and bonds owned by the company, or held by it in any trust capacity, should be entered, showing the amount of each kind of security in the possession of the company. This book is not only an additional check upon the trust and general ledger entries referring to stocks and bonds, but it is also a ready reference book to turn to in case an officer of the company desires at any time to know the amount of any particular security under the control of the company.

One of the important books that should be kept is a register of securities. containing not only bonds and stocks, but notes as well, with full data regarding each class of security. The securities held by each trust should be entered by themselves. The book should provide for a record of interest or dividend payments, so that from time to time when the book is examined the information as to such payments can be readily obtained.

A daily balance sheet should be kept, in which all the totals should be brought together for the information of the officers; also a tickler showing the due dates of notes, etc., to be collected from time to time.

A daily memorandum tickler is also a useful book to have, in which should be entered sundry memoranda relating to the various trusts that might otherwise be forgotten at the time when most needed.

The real estate loan records should be very complete, as these books are being constantly referred to; and entries when made should be carefully checked by another clerk than the one making them. This rule should apply to all books kept by the company. Full and complete records should be kept of all matters relating to rentals collected, insurance, etc., also of any securities that are past due or of doubtful value.

The expense account should be abstracted in a book kept for that purpose, and carefully compared and checked with the general ledger. It is also advisable to keep for future reference, in a book prepared for that purpose, memoranda of all conversations had

with prospective clients. All tickets from which the original entries are made should be clear and concise in form, giving in themselves all the information necessary from which to make perfect entries on the books.

I have not attempted to deal with the many special forms of books and blanks relating to bond trusteeships or to the registration and transfer of stocks. The large majority of trust companies handle very little of this class of business, as it naturally goes to larger financial centers. But I have endeavored to treat of those forms which would prove useful to almost every company in the country doing a trust business.

I am aware that the loose leaf system of bookkeeping is receiving much attention in these days. And I am prepared to admit that there are many minor books in which it can be used to advantage. But I have had, and still have, a prejudice against its use for books of original entry, as it is not a difficult matter to take out a leaf from a book made on this principle, while it is almost impossible to detach a leaf from a book properly made and bound in the regular manner. The book of trust company forms referred to a short time since contains the ideas of the committee upon this subject.

In closing let me suggest that it would be well for every trust company to have one man in their service whose duty it shall be not only to keep books in touch with its system of accounting, but constantly to endeavor to improve and simplify its forms. Again I repeat, make the forms as simple as is consistent with full and complete entries. See that every account on the general ledger is checked by entries made on another book or other books. For example, the stock and bond account in the general ledger should agree with the balance sheet of the stock and bond ledger, and also with the totals of stocks and bonds shown in the register of securities. Then the officers of the company will seldom be troubled over their system of accounting. The business is eminently one of details, which demand constant watchfulness and attention, and the system that renders this work easy to the officers and employees is the one to follow.

AN ELEMENT OF DANGER TO BANKS IN MUNICIPAL BONDS AS SECURITY

ADDRESS DELIVERED BY CLARK WILLIAMS, VICE-PRESIDENT OF THE COLUMBIA TRUST COMPANY OF NEW YORK CITY, BEFORE NEW JERSEY BANKERS' ASSOCIATION AT ATLANTIC CITY, MARCH, 1905.

IN times of progress such as these, when conditions are constantly arising presenting new and varied problems, it is proper that those affected by these changes should look carefully to their interests in attaining a wise and intelligent solution of the questions resulting from this development. And the banker, the conservator of the material wealth of this great country, has his duty along with the rest who in the work of life accept definite responsibilities. He has, as a continuing duty, the study of methods by which to maintain, under changing conditions, adequate protection for the great interests he represents. One of the problems with which he is confronted in this study of method it is my purpose to discuss.

Not long ago a condition arose in the financial development of our country which justified the Secretary of the Treasury, in the exercise of his prerogative, in accepting from the banks as security for the deposit of public moneys the evidences of public obligation other than those of the federal government. These obligations are commonly called municipal bonds, whether they be the issue of cities, counties, school districts, or states. This, however, was by no means the banker's introduction to these securities, for in the development of our public improvements not only have they come into the counting room as collateral for loans and as investments, but I venture to say there are but few issues of these bonds in which the local banker is not appealed to for counsel and advice. When we consider that the indebtedness of this character in the United States, after deducting sinking fund accumulations, exceeds $2,000,000,000, we are able to realize the enormous investment in municipal bonds.

The high public credit of this country has established for these bonds an exceedingly low interest rate, and besides the federal sanction referred to, the laws in all states have discriminated in their favor as a proper investment for savings banks and trust funds. One would suppose that the issue of securities of this high character, providing to so large an extent the investments of the country,

would be surrounded by every safeguard for the protection of the issuing community and the security of the investor. Is this the case?

Public officials are usually unfamiliar with the methods well established in the issue of other securities, and often are even without experience in the issue of municipal bonds because of the frequent changes in office tenure; yet this county supervisor or that city clerk must superintend, according to his own uncertain methods or under the direction of the purchaser, the preparation and negotiation of these bonds, which find their way into the vaults of our banks as collateral or as investments. The purchaser receives securities which are printed or cheaply lithographed on blanks obtainable from any stationer or printer. If their preparation is so elaborate as to require the use of plates after they have served their purpose these are considered of small value, are carelessly held by the printer, and are apt to fall into improper hands. The result is that in no class of security have errors in issue been so common or duplication and fraud been so widely carried on as in municipal bonds. Besides the abundant opportunity for error in their preparation and execution, the prevailing method, or lack of method, of issue, is almost an invitation to the unscrupulous to duplicate parts of or entire issues.

The conditions surrounding the issue of municipal bonds, as I have stated them, may to some seem to involve no unusual danger, and I regret that I am unable in this short time to prove my case more clearly by reference to many over-issues through carelessness or fraud that have come to my notice. I may mention a few, however, of special interest:

Several years ago, one Quigley was considered to be a reputable bond dealer in New York City. The following item from the *Bankers' Magazine* explains itself: "On January 19 it was announced that the Mercantile National Bank at 191 Broadway had been swindled out of $144,000 by Edwin O. Quigley, a well-known bond broker of New York, of the firm of Quigley & Tuttle, of 6 Wall street. Quigley was arrested, confessed his guilt, and was afterwards sentenced to fifteen and one-half years' imprisonment."

Mr. William P. St. John, then president of the Mercantile National Bank, made the following statement in regard to Quigley's

stealings: "Our total advances to Quigley were $144,000 on bonds of the par value of $160,000. Quigley has kept an active account with us for some time. All these bonds we now believe to be forgeries. We discovered yesterday that one of these bonds was a forgery, and to-day Quigley admitted to us that all of them were fraudulent. The bonds comprised $57,000 city of Cleveland bonds, $68,000 bonds of the city of Springfield, $35,000 of the city of Harrisburg, and $6,000 bonds of the city of Zanesville."

Other banks out of New York are known to have been victims of Quigley's frauds, but it is not known how many bonds he forged. The Brooklyn *Eagle* subsequently reported: "It is known that F. R. Warley, of 180 Broadway, New York, who lithographed the bogus bonds for Quigley, printed in all $640,000 worth. The forger made a statement to the effect that Warley had no knowledge whatever that his transactions were anything but honest."

Quigley's method of operation was as follows: On the purchase of an issue of municipal bonds at public offering or private sale he would give his services in the preparation of the documents without cost to the municipality, arguing that his familiarity with the requirements of the investing public would save inconvenience and produce better results—an attractive proposition to most public officials. A lithographer acting innocently or with only the size of his order in view, was then commissioned to produce two sets of bonds identical in all respects. One set would be properly executed by the officials and sold to the public; the other would be duly signed and sealed by Mr. Quigley and deposited as collateral with the banks.

While Mr. Quigley was thus successfully doubling his capital in New York, Mr. Z. T. Lewis was industriously plying the same trade in Ohio, with the following results, as cited in the *Financial Record:* "Much anxiety is felt concerning the affairs of Z. T. Lewis, missing broker of Dayton, Ohio, who was recently awarded $300,000 McKeesport, Pa., bonds. Forged bonds have turned up to the amount of $56,000, and it is believed that the amount will reach over $100,000. Twenty thousand dollars fraudulent bonds of Highland County; $25,000 Kenton City School, and $10,000 Tippecanoe City School bonds have come to light. The bank of which Mr. Lewis was president has been closed."

Twenty years ago the state of Virginia ordered engraved a large

issue of bonds, for which, owing to a change of administration, the state officials refused to pay. Because of the indifference of these officials, the blank bonds were sold by the express company to pay charges, and were widely scattered. They have been turning up in small blocks ever since, variously signed, with and without seals.

I have frequently requested samples of work from lithographers who have solicited our business, to confirm my opinion of their average carelessness, and I have often been given bonds with coupons attached bearing the lithographed facsimile signature without the slightest attempt at cancellation.

In advocating the more adequate protection of municipal securities to a firm of Chicago bond dealers some years ago, I took occasion to display a lithographed blank bearing the likeness of a woman as one of the vignettes, stating that these blanks could be obtained by the cart-load from any stationer or lithographer. My listener looked at it in amazement, informing me that the portrait on this blank was the likeness of his wife, and expressing great surprise that the original plates which had been prepared for his exclusive use had found their way into the profane hands of New York lithographers.

It was my duty years ago to examine the loans of an institution carrying a large amount of municipal bonds as collateral. One-third of the securities were printed in the same colored ink, on the same blanks. There was absolutely no evidence that these bonds were what they purported to be. None of the officers of this institution were familiar with the signature of the mayor of this town, of the county clerk of that county. The loans were practically secured only by the obligation of the borrower. For banks loaning on such supposed securities to ascertain, by investigation, the genuineness of every block of bonds offered as collateral would entail an enormous amount of research, consuming frequently weeks of time and practically prohibiting loans of this character.

At times the loss of credit to municipalities as the result of irregularities or fraudulent issues of their securities has been serious, and a just prejudice exists in the minds of many an investor that militates against the broad market which these securities deserve. The danger to investors is only second to that of bankers loaning on the bonds. The principal and interest of such bonds are very frequently payable at the office of the dealer purchasing them, and he

has only to furnish his customers fictitious bonds and then to pay the coupons as they are presented at his office, thus providing himself with a cheap working capital which is capable of being indefinitely increased to the limit of the confidence of his clients.

The schemes for obtaining money by means of the irregular issue of these bonds could, at the hands of a brainy scoundrel, be varied indefinitely, and it is impossible to state the extent to which such business is carried, for so long as the borrower pays his interest promptly and takes up his loans at maturity, their fraudulent character remains undiscovered. Nor is the unprincipled dealer the only danger to be provided against; municipal officials and their clerks are as prone to commit errors as other human beings, and instances are not wanting where bonds prepared or executed in a manner not satisfactory to the purchasers have been laid aside, other bonds executed, and afterwards the original bonds sold.

Enough has been said to show the points of danger and the necessity for adequate remedy. This remedy must lie in a method of issue which will properly protect the interest of all concerned, and at the same time so serve their convenience as to render the plan attractive. As far as it is possible, such a plan must be an absolute protection to communities issuing the obligation against the payment of fraudulent bonds and coupons; to public officials who are responsible for the proper issue of these securities and who may lack the requisite experience; to dealers who, under the present conditions are practically the guarantors of the bonds they sell, a needless and heavy responsibility; to bankers offered a high class of collateral for loans, but having no facilities for determining its genuineness or legality; to investors willing to accept low rates of interest on obtaining absolute security, and who yet are not protected against entire loss through fraud.

Such a plan must begin with the very inception of the issue and end only with the delivery of the completed instruments to the proper city officials or the purchaser, and every step between must be protected with effective safeguards under the supervision of a responsible corporation. The safeguards surrounding the issue of securities listed on the principal exchanges, where duplication and overissues are practically unknown, at once suggest themselves. Their protection primarily lies in engraving by responsible bank-note com-

panies from steel plates, together with the evidence of genuineness of a responsible trust company, whether it be in the signature under the trustee's certificate on bonds or in the signature indicating the registration or the proper transfer of stock. Municipal bonds should be carefully engraved by a responsible company, producing the best workmanship and giving absolute security during the different stages of preparation, as well as exercising a careful guardianship over the engravings afterwards, to prevent either plates or impressions falling into improper hands. A certificate signed by a responsible fiduciary institution should appear on each bond, evidencing the genuineness of execution and a guarantee against over-issue through carelessness or fraud.

Because of the peculiar conditions under which municipal bonds are issued, the question of legality is of so great importance to the investor that such investigations should be made by counsel specially qualified by experience to pass upon the intricate questions involved in their validity of issue. A certificate of legality should appear on each bond, or a reference to the fact that such legal examination has been made and that the legal papers relating to the issue are filed with the trust company which would be responsible for the genuineness of the certificate—in this way avoiding the constantly recurring expense and delay of examination of the legality of the security by counsel for each new purchaser. The trust company, however, certifying the bond as to its genuineness, should be particular to assume no responsibility as to its validity. A convenient place of registration should be provided in the chief financial centres of the country, to save purchasers the inconvenience and expense of forwarding securities to the place of issue in order to obtain registration in their names. The payment of interest should be arranged for at the office of responsible and experienced agents at the financial centres, affording conveniences to investors and a safeguard against the acceptance of fraudulent coupons.

It has been abundantly proved by experience that municipal bonds advertised as being issued under the safeguards outlined are more acceptable to the investor and command a higher price at public sale. The evidences of Federal obligation are surrounded with safeguards in issue analagous to those we have outlined. Corporations have long attained the same result in the issue of their secu-

rities through the instrumentality of the trust companies. Municipal officials are beginning to realize the virtue of this protection in the issue of their bonds, and with a clearer understanding of the dangers involved under the old methods, we believe that the hearty co-operation of the banker may be relied upon for the better protection of the great interests involved.

THE DUTIES AND LIABILITIES OF TRUST COMPANIES ACTING AS TRANSFER AGENTS AND REGISTRARS

ADDRESS DELIVERED BY HENRY J. BOWDOIN, OF BALTIMORE, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT RICHMOND, VA., OCTOBER, 1900.

THE office of transfer agent and registrar of stock is an interesting instance of the operation of forces which may, from time to time, arise in the business world, and, becoming operative, produce their effect in the form of an established business custom. In analogy, however, to the physical law of motion, the final resultant of such forces, the established business custom in question may, through the inertia of a movement once started, become crystallized at a point far beyond that at first contemplated, and may ultimately involve legal relations and responsibilities, not at first recognized, and which remain undetermined until some combination of circumstances brings the established custom before the courts for interpretation. Until the statute law or the courts have so defined or interpreted the legal responsibilities incident to such custom, all transactions within its scope are enshrouded in an uncertainty and doubt, except to the extent to which light may be thrown by the application of general legal principles.

It is to the consideration of such a situation that I now invite your attention for a few minutes—to the legal and business questions involved in the position of a trust company acting as the transfer agent or registrar of the stock of another corporation.

An effort to determine the primary operative reason for the now almost universal custom of appointing a transfer agent for the stocks of large corporations is of interest and importance, since

such reasons are in themselves explanatory of the purpose and intent of those who enter into the legal relations involved in the office, and are also evidence of the purpose of those who have operated in such office or position in the expectation that the discharge of the functions of the office would meet the requirements of such intent and purpose. I have not been able to determine definitely the causes which have resulted in this well-established custom, but it is reasonably certain that it is the evolution of a process of thought and reason running in the following groove: It is universally established that the transfer of title to stock is not complete for all purposes, nor properly evidenced, until the transferee or purchaser has been registered as stockholder upon the books of the corporation. Such registration and notation of transfer can be performed by the selling owner in person, or by his duly authorized attorney; and we all know that the latter course is the one almost universally adopted. Business convenience, or the inexorable demand for business facilities, and the enormous volume of stock transferred, then created the necessity for and the custom of appointing an agent, whose sole duty it was to attend to those transfers, perfect them, complete the transaction involved in the purchase and sale of stock, and furnish the evidence of such completed transaction by the issue of a new certificate to the transferee. Both the necessity for the office and its importance were, of course, apparent. Then, doubtless the advisability of throwing every possible safeguard around the issue and transfer of stock being equally apparent, the advantage gained by increasing the difficulty of dishonest combinations between the officers of the corporation, through an increase of the number of persons whose complicity would be essential to any fraud, resulted in the custom of selecting a corporate agent, a trust company, and appointing it the transfer agent. The capital and surplus of this transfer agent is probably in excess of that of the company for which it is acting as such agent; doubtless the trust company is so selected from among others largely because of its prominence, financial responsibility, and the consequent security which it offers to all those who deal with it. We may fairly assume that such are the causes which were creative of the now well-established custom of appointing trust companies as transfer agents for the stocks of other corporations.

Of course, we all know that the security which was sought to be gained through a multiplicity of officers whose signatures upon the certificates were essential to their validity in many instances no longer exists in fact, because it is quite customary for corporations to have large numbers of their certificates of stock duly signed, leaving only the name of the stockholder and the number of shares blank, and intrusting the certificates in this condition in the hands of the transfer agent. Nevertheless, the fact that this one primary reason for the establishment of the office has in this manner really ceased to exist does not create any probability of the ultimate abandonment of the custom. The other reasons for its creation still exist, and the continuance of the custom is largely insured by the fact that the omission of a transfer agent would be regarded as suspicious and irregular. In fact, many of the stock exchanges require the appointment of a transfer agent, as a condition precedent to the placing of a stock upon their lists, and corporations are now so eager to assume all indicia of caution and conservatism that we often see a provision placed upon the face of the certificate to the effect that the certificate is not valid unless signed by the transfer agent. In several instances I have seen this provision carried to the extent of requiring, not only the signature of the transfer agent, but also the signature of the registrar, as essential to the validity of the certificate.

The office of transfer agent may be regarded as a permanent institution; it should certainly be reckoned with as such. A trust company occupying this office assumes a twofold obligation; certainly it assumes a twofold relation: first, to the corporation for which it acts as agent, which we will designate the principal; and, second, to those who have an interest in the stock transferred.

The relation between the agent and the principal is usually created by a resolution of the board of the latter designating the company as transfer agent, accompanied by the payment of an agreed sum, which is supposed to compensate the agent for the clerical work involved in making transfers during the succeeding twelve months; the compensation is based upon the anticipated activity of the stock. By clear implication the agent holds itself out as competent to discharge the duties of the office. What are those duties?

Broadly speaking, the agent agrees to perform for the principal the work of passing upon the evidence of transfer of title to the principal's stock, and of perfecting such transfers as are in proper shape by the due notation of the transfer and the issue of a new certificate. If no agent were appointed, the corporation principal would itself perform all this work, and, of course, all the liabilities incident thereto, would rest upon it; and such was the case until the custom and office in question were created. But having appointed such agent, what measure of responsibility to the principal attaches to the agency, and is impliedly assumed by the agent in accepting the office?

At this point we pass beyond the circle of light thrown by established law, and find ourselves involved in uncertainty and doubt. Is the relation so established between the principal and agent that of simple agency, to which the usual law of such relation may be applied with certainty, and the liability of the agent may be considered with confidence as limited to the consequences of lack of good faith and ordinary skill, competency, and knowledge? Or must the duties assumed by the agent be so performed as to satisfy the requirements of the situation, which would exist if no agent had been appointed, but the principal had remained in direct touch with its stockholders, and without the interposition of any intermediary? In other words, must the agent so perform its duties as fully to discharge the responsibility which the principal is under to its stockholders in all that pertains to the preservation of the stockholders' interest and title, until such interest and title is duly divested and transferred, and is the agent responsible for all consequences ensuing to the principal from a failure so to perform its duties?

In an effort to reach a conclusion upon the measure of responsibility assumed, it should be borne in mind that the creation of the office is, apparently at least, due to pressure rather from without than from within the corporation. This creation is not due to the requirements of business facilities and convenience of the corporation in perfecting the current transfers of its stock, but is due, certainly in great measure, to influences outside the corporation to a demand for security not afforded within the corporation's own organization, and consequently sought for outside that organiza-

tion, through a separate existence, removed as far as possible from the influences and control of that organization.

The decisions of record, so far as I have been able to discover, are upon cases where there was some gross default by the agent in the discharge of its duties. I find no case presented involving the liability to the principal when due care, skill, and knowledge were exercised, nor where the court has decided what, in any specific case, would constitute due care, skill, and knowledge. But in view of the causes which have resulted in the office and custom, and of the practically absolute control exercised in most instances by the agent, it is certainly prudent for us to anticipate that the courts will decide, when a proper case is presented, that the agent is responsible to its principal in the full measure of the consequences resulting to the principal for any acts of the agent.

The degree of legal liability to the principal may, of course, be restricted by the terms of any agreement entered into between the principal and the agent, and such limitation may be made operative between the agent and those interested in the stock transferred, if the latter are charged with legal notice of the restriction upon full liability; but certainly in the great majority of instances the relation is created by the method described; that is, by a resolution of the board of the principal designating the company which is to act as transfer agent, and the tacit acceptance by the latter of the duties of the office, and the fee agreed upon. Clearly there is no limitation of liability here—the relation is left charged with such responsibilities as the court may decide to be implied in the transaction. Can it be successfully argued that, while the agent agreed to perform the work, and accepted a cash consideration therefor, the responsibility for the consequences of mistake, however innocent, impliedly remains where it formerly rested, upon the principal, it having parted with the control of the situation? I apprehend not.

If such be the conclusion which courts will reach, we are confronted by the fact that the many legal questions and difficulties involved in the transfer of stock—questions which have brought forth volumes of legal textbooks and decisions—are presented to the agent, or, speaking more practically, to the knowledge of its transfer clerk, and his discretion and discrimination in determining what questions should be referred to counsel for solution and action.

The agent must not do, or leave undone, any matter of thing whatsoever by which its principal suffers loss directly, or by which it falls under liability to anyone having property interest in its stock by reason of any impairment of that interest. The agent must see that there is no overissue of stock, either by direct fraudulent act of its own employees, or by issue of new certificates upon surrender of old ones with forged indorsements, or by permitting an unauthorized transfer of stock, thereby rendering possible the fraudulent loss to innocent parties, even if unknown and practically unknowable either to the principal or the agent. The agent is charged with knowledge of the signatures of the stockholders of its principal, and with the legal capacity of the stockholder to transfer his stock. For example, in the case of Chew vs. Bank (Maryland 292), a corporation was held liable for permitting a transfer upon the genuine signature of a stockholder who had become non compos, a fact of which the defendant was in complete ignorance. If this bank had been fortunate enough to have appointed a strong trust company as transfer agent, and this stock transfer had been passed by its agent, the ultimate liability might have been shifted. Again, the agent is charged with knowledge of the terms and powers under which a trustee stockholder acts, it having been decided that the word "trustee" on a certificate of stock carries with it, in many cases, responsibility of full knowledge of the powers of the trustee and the terms of the trust. A refusal by an agent to transfer stock on demand is ground for suit, unless it is ultimately decided that the refusal was based upon adequate reasons, or upon lack of proper evidence of the right to demand transfer.

Of course, the agent is responsible to its principal for all acts of fraud or negligence committed by the agent, or by anyone in its employ, by which the principal suffers loss or damage. It is practically impossible for the higher officers of the agent to scrutinize every transfer or to keep the principal's certificate book under personal guard, so that many opportunities for fraud are open to the agent's clerk having charge of transfers and with the certificate book of the principal, signed in blank, in his possession. The case of Bank of Kentucky vs. Schuylkill Bank (1 Parson's Select Equity Cases 180) is instructive as being a leading one; and one of the few instances in which the legal relations which we are considering have

come before the court for interpretation, and interesting as showing the utter disproportion between the average fee of the transfer agent and the financial responsibility assumed.

This was a bill in equity in 1839, brought by the Bank of Kentucky, a corporation created by the state of Kentucky, against the Schuylkill Bank. The plaintiff had the power under its charter to establish transfer agents where it pleased, which power was exercised, and the Schuylkill Bank was appointed its transfer agent in Philadelphia, on a salary of $500 per annum. The bill charged and the proof showed that Levis, cashier of the defendant, who had charge of the transfer of the plaintiff's stock, made a fraudulent overissue to the extent of about $1,300,000. The bill also charged that the plaintiff was being sued by some of the holders of the spurious stock, and that it had purchased some of the said stock in the hands of innocent purchasers without notice, and that it was ready to do the like in all such cases. The plaintiff further claimed that, by virtue of an act of assembly of the state of Pennsylvania, it represented all the holders of said stock. It asked, among other things, for an accounting, and for a decree against the defendant for the par value of the stock thus surreptitiously issued, with interest thereon, and also for damages sustained. The court decreed that the defendant pay unto the plaintiff $1,184,738 as a just indemnity for the loss, detriment, and damages to which the plaintiff and the holders of the stock had been put or suffered by reason of the fraudulent issue of 13,185 shares of stock of the plaintiff by the defendant while transfer agent of the plaintiff, through the knowledge, procurement, and assistance of Levis. In reaching this conclusion the court used the following language:

What is a transfer agency? It is a very harmless thing. It amounts to nothing more than the witnessing of the conveyance by one person to another of personal property, viz., stock of an incorporated company; and in this case, also, to furnishing the purchaser a certificate of ownership of such stock, on the surrender of a previous certificate of like character held by the seller.

This is a very simple business, involving little or no risk or hazard; requiring nothing but ordinary care and fidelity in its performance. If the necessities of one bank require its stock to be transferred in another place, whether in the state of its creation or out of it, why cannot it ask aid of a correspondent bank that does all its other business in such place? And why cannot such correspondent bank afford the aid required? In the charter of the Schuylkill Bank there is found nothing in terms forbidding the execu-

tion of such a friendly office, either to another bank of our own or of a sister-state. (P. 217.)

First, it is contended that the contract for this agency being made by the president and directors of an incorporated bank, it became, from a necessity equally known to both parties, requisite to employ the assistance of sub-agents in its execution; that the cashier of the Schuylkill Bank was the sub-agent, so chosen by that corporation with the assent and approbation of the complainants; that all the frauds charged in the bill were perpetrated by him without the conusance and connivance of the president; and that under such circumstances the bank is no further responsible for his acts than arises from the general obligation of every principal agent to act with good faith and ordinary care in the selection of a secondary agent. The principle on which this position rests is the familiar one that when it is usual and necessary for a principal agent to employ a sub-agent, as for example a broker or auctioneer, to transact the business, in such a case the principal agent will not ordinarily be held responsible for the negligence, or misconduct of the sub-agent, if he has used reasonable diligence in his choice as to the skill and ability of the sub-agent. But, indisputable as is this principle, it has no relevancy to an agency like the present. The cashier of a bank, while carrying into execution, under the orders of the directors, a lawful contract, such as the contract of creating this agency is shown to have been, is in no sense of the word a sub-agent of the board of directors. (Pp. 239, 240.)

In fact, when the business of the agency has reached that point, the principal agent is not an agent so much to sell as to select on behalf of his principal someone competent to execute a necessary function for him, which the agent cannot perform himself; and all the cases referred to in this connection are but the various developments of this common principle. But was it ever heard of that an agent charged with negligence or fraud could relieve himself from liability to his principal by showing that his clerk or porter were the immediate actors in the wrong and acted without his authority? If such metaphysical niceties would be at once repudiated in a natural person, why should they be recognized in a corporation? (P. 241.)

The comments of the court upon the general nature of the relation are, I take it, obiter dicta, and, not being essential to the conclusion reached by the court, are deprived of all weight as precedent or decision. You observe that in this case the defendant was not allowed to plead its due diligence and care in selecting its cashier, but was held to full accountability to its principal. I can find no sufficient reason upon which to base a theory that would differentiate between the ultimate responsibility for such fraud as was perpetrated in the Kentucky bank case and the ultimate responsibility for the consequences of passing a forged or unauthorized transfer, with absolute innocence of intent upon the part of the agent and its employees. Let us assume that the plaintiff is an infant who has

been injured by the defalcation of its trustee in transferring stock; the corporation whose stock is so transferred is clearly liable (Marbury vs. Ehlen, 72 Md. 206). Is not the agent who was paid by that corporation to assume for it the duties of making its transfers liable in turn to that corporation for the consequences of an improper performance of those duties?

The decisions upon the liability of the transfer agent to the principal are few in number; the direct liability of the transfer agent to the injured stockholder has apparently not been before a court of last resort, but the application of established legal principles to the latter proposition would seem to fix the agent's liability to the stockholder as completely as the decisions noted established the agent's liability to its principal, and we reach the conclusion that the agent must answer to the stockholder for all damages suffered by the former through such illegal or unauthorized transfers for which the corporation whose stock is so transferred would be held liable. The stockholder's case against the agent is strengthened by a regulation of the stock exchange requiring the appointment of a transfer agent—for such requirement is in the nature of a demanded safeguard and precaution upon which the stockholder and the stock-trading public have a right to rely. The case becomes still stronger if the certificate contains a statement or notice that its validity is dependent upon the signature of the transfer agent; for in that instance such certificate gives to the certificate a validity and credit which it would not have unless so signed. Such stock-exchange requirements for listing, and such provisions on the face of the certificate, would seem strongly to emphasize the responsibility which the agent assumes toward its principal and the latter's stockholders. Apparently the injured stockholder could successfully pursue either his corporation, the principal, or the agent, or both.

At the second annual meeting of this section (August 24, 1898) an able paper upon this general subject was presented by Mr. Felix Rackemann a counsel of the Old Colony Trust Company, Boston, in which the author drew a distinction between the legal responsibilities of a transfer agent and those of a registrar or corporate securities, considering that the latter were broader than the former. He places the origin of the office in the fraudulent overissue of the stock of the New York & New Haven Railroad Company by its

president and transfer agent, the transaction being known as the "Schuyler Frauds." (N. Y. & N. H. Rd. vs. Schuyler, 34 N. Y. 30.) This occurrence emphasized the necessity of further safeguards around the issue and transfers of stock, and resulted in the passage (in January, 1869) of a regulation by the New York Stock Exchange under the terms of which corporations whose stocks are listed are required to appoint a responsible agency at which a registry of the stock shall be kept. The keeper of this registry is known as the registrar. The sole purpose of the office seems to have been creation of another check against overissue.

The appointment is made by resolution of the board of the appointing company, and is accompanied by the payment of a small cash consideration, gauged by the degree of activity with which it is anticipated the stock will be transferred or dealt in. The transfer agent makes the transfer, issues the new certificate to the transferee, which, together with the old certificate and such separate powers or evidences as may accompany it, are sent to the registrar and duly noted upon books kept for that purpose. Since the function to be performed by the registrar, which it holds itself out as competent to discharge, is that of a check against the transfer agent in guarding against an overissue of stock, it becomes necessary for the registrar to scrutinize all transfers, since the issue of a certificate, except against one, legally canceled, for the same number of shares, would necessarily result in an overissue. This duty the registrar impliedly, by its acceptance of the office and fee, agrees to discharge.

Obviously, if the registrar certifies the issuance of a certificate, thereby placing upon it the last and highest indicia of validity, and loss results to the principal therefrom, the registrar has failed to fulfill the purpose of its appointment. If, by such action, loss inures to a stockholder whose property rights have been wrongfully divested thereby, cannot such stockholder recover from the registrar, the signature of the latter, in acceptance and approval of the evidences of the transfer, being essential to the transfer and being the last act in consummation of the transaction by which the stockholder is injured? In the absence of an expressed agreement limiting the liability of the registrar, it would seem that the acceptance of the office carries an acceptance of responsibility for failure

properly to perform the functions of the office, and that, unless such limitation of liability is brought to the knowledge of the stockholder, and of those who may, from time to time, become such, the acceptance of the office would also imply an acceptance of responsibility for all acts for the registrar whereby the stockholder is wrongfully deprived of his property interest in the stock. Here again the case against the registrar is strengthened by the quite customary regulations of stock exchanges requiring the signature or counter-signature of a registrar as essential to the validity of the certificate. The duties and liability of registrar do not, in my opinion, differ in any marked degree from those of a transfer agent.

It has been suggested that in case of difficulty or doubt, the responsibility of decision should be thrown by the agent or registrar upon the principal, and definite instructions asked for. This request would, if answered, relieve the agent from liability to the principal. It would certainly be evidence that the agent considered itself liable only for the usual responsibility of an agent; but I doubt the practical value of the suggestion, because the request for instructions by the agent would probably not meet with any satisfactory response. I have, in representing a transfer agent, asked the principal for instructions, and to my surprise received them. I anticipated, however, at the time that the principal's reply would practically be: "You have been paid to perform the work of noting our transfers, and have, by acceptance of your fee, agreed to decide these questions yourself and assume the consequences of an erroneous decision; therefore we decline to instruct you and thereby reassume the ultimate consequences of mistake in the law or facts. Your signature is essential to the validity of the new certificates, and you put it on or refuse it at your peril, not ours." Such position would be difficult to assail, and I am strongly inclined to the belief that such would be my position if, representing the principal, I were applied to for instructions by a transfer agent or registrar.

It may be that the weight of ultimate decisions by the courts, when the responsibilities of these offices have been presented for determination, will result in the application of the general rule governing the relation of principal and agent, and in holding the agent responsible only for the consequences of due care, skill, and knowledge, and in establishing that such measure of responsibility only

attaches to or is implied by the assumption of the office. But if such is the case, it remains true that the questions which may arise in the transfer of stocks are most obscure and involved, and that the assumption of the skill and knowledge requisite to discharge the duty of passing upon such questions is a dangerous duty for any corporation to assume. The responsibility of passing on transfers is one of the most important duties devolving upon the counsel of any corporation. As the number of corporations for which a trust company acts as transfer agent or registrar increases, the weight of its responsibility as such agent, even under the usual limitations of an agent's liability, also increases through multiplication of the chances of innocent error and mistake, in proportions which it is not pleasant to contemplate.

It would seem here that a point has been reached when trust companies may, with possible advantage, pause to investigate and consider carefully the degree of liability which we so readily assume in accepting the position of transfer agent and registrar, and, this being determined, to see if the scale of fees is commensurate with that responsibility. Evidently the primary operative causes have resulted in the creation of an office which involves more liability than would, at first sight, have been supposed to attach thereto. Possibly the nomenclature of these offices—"agent," one who acts for another, and "registrar," one who performs the act of registering—has obscured the true relation and has created a feeling of confidence which is misplaced. Certainly it is anomalous that the extreme care and ingenuity which have been displayed in expressly limiting the liability of the trustee in the discharge of the trust under a corporate mortgage, nowhere appears in restricting the responsibility in making transfers of stocks in transactions involving untold amounts. If the degree of responsibility is that which I have indicated, and the legal relation is not that of agent and principal, that nomenclature being misleading, but is that of employer and employee, the transfer agent having assumed for a cash consideration all the responsibilities incident to the proper performance of the work, both to the body corporate so employing and to its individual members—those interested in its stock—is not the average of fees paid for such work entirely incommensurate with the risk, even applying as a standard the rate of premium charged

by bonding companies under the existing conditions of unbridled competition? It would seem to be scarcely commensurate with the responsibility assumed, even if the liability is only to exercise due care, skill, and knowledge in such transactions.

If my views are correct, we are now engaged in the cheapest form of insurance ever devised. It is good business for the average corporation to employ a strong trust company to make its transfers, and, for a few hundred dollars' premium, assume the risks of defalcation and innocent error. Of course, the large majority of transfers are in usual course of stock-exchange business, and present no new or novel conditions, and only those in which statute or established decisions furnish a safe guide; but we may be at any moment called out of the beaten path and confronted with facts, essential and with but little to indicate their existence, to which the well-known legal principles and customary procedure may or may not apply, and upon the decision to transfer or not transfer may depend a possible heavy loss.

In presenting these views I am conscious of occupying the uncomfortable but relatively easy position of a critic of existing conditions who is unprepared to suggest an adequate remedy. If, however, the matter receives your consideration and that of your counsel, some system will doubtless be devised by which the degree of liability which we are willing to assume will be defined and properly evidenced, or a scale of fees will be established which fairly represents the responsibilities assumed, if they are determined, or the risks involved, if the responsibilities of the office remain undetermined.

THE PROTECTION OF TRUST COMPANIES AS TRANSFER AGENTS AND REGISTRARS

ADDRESS DELIVERED BY JORDAN J. ROLLINS, OF THE NEW YORK BAR, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT NEW YORK, SEPTEMBER, 1904.

THE functions of transfer agents and registrars of corporate securities are not discharged to any great extent by corporations in the United States outside of the larger cities. Nevertheless, the subject of the obligations and liabilities incurred by corporations in the assumption of those duties is probably of interest to all representatives of trust companies wherever organized, and has, no doubt, been the subject of earnest thought on the part of each of those representatives. Therefore, it is to be hoped that a consideration of how the trust company may best be protected in the discharge of the important duties of those two offices will prove of common interest to you all, even though that consideration in large part dwells upon conditions as they obtain in the state where you have now met. What is true of the law of New York, or the lack of it, as regards authoritative adjudications upon the subject which we propose to discuss, is likewise applicable to other parts of the country, subject only to slight changes or modifications; for, as will be seen, the necessity for the corporate transfer agent or registrar, and the special fitness of the trust company to act in those capacities, are natural consequences of general business methods, and not of mere local custom.

The New York Stock Exchange lays down the rule that: "Corporations whose shares are admitted to dealings upon the exchange will be required to maintain a transfer agency and a registry office in the City of New York, Borough of Manhattan."

Both the Stock Exchange and the Legislature seem to have taken it for granted that the duties and liabilities of a transfer agent and of a registrar were so perfectly understood as to need no definition or regulation. But a careful investigation of the subject leads to the conviction that those duties and liabilities have never been clearly fixed or determined, either by authority or custom. While each particular instance of transfer agency is, like any other agency, created by the contract between principal and agent, that contract is generally in substance a mere resolution by the board of directors of the principal company that some other company act in that

capacity, and the assumption of the work by the designated company, in pursuance of such resolution. The appointment of the registrar is effected in much the same way. The contracts thus created are, therefore, peculiarly open to variation in judicial interpretation by the inclusion of implied provisions. The result is that trust companies find themselves to-day engaged in a large and growing branch of business, the conditions of which are not plainly defined and are to be determined only by a careful consideration of the elements which have combined to create independent transfer agency and registry and make them corporate functions.

While you all know and understand the obligations of a company to its stockholders regarding the transfer of the certificates of its stock, it may not be amiss, in approaching the question before us—the due protection of a trust company in acting as transfer agent and registrar of another corporation—to direct your attention to a few cases in which the disastrous consequences that have befallen corporations through the improper transfer of their certificates are clearly set forth. These cases have been chosen with the purpose of showing that liability can arise equally through honest mistake, negligence, or fraud. In each instance, it is gratifying to note, they had their origin, not in the employment of a corporate transfer agent, but in the acts of officers of the issuing company.

A wrongful transfer may occur, for example, through a mistake of fact where the title to stock is affected by some law peculiar to a foreign state or country or by some complicated contractual relation. A case passed in review by the Court of Appeals of New York in 1901 (Central Trust Co. v. W. India Imp. Co., 169 N. Y. 314), where title to stock was subject to questions arising both from peculiar foreign law and contractual complications, affords a striking illustration of the uncertainty which may attend the task of transferring stock of a foreign corporation.

The West India Improvement Company, which was a New York corporation, mortgaged all property then owned or thereafter acquired by it to the Central Trust Company, for the benefit of bondholders. Subsequently, the Improvement Company became the owner of the stock of the Jamaica Railway Company, a corporation organized under the laws of Jamaica, but instead of delivering the certificates so acquired to the Central Trust Company pursuant to

the terms of the mortgage, pledged them with the Manhattan Trust Company as security for loans evidenced by notes. "Subsequently, as found by the referee, ... the legal title to the shares of stock was transferred to the defendant, the Manhattan Trust Company." (by this the referee probably meant that the record of transfer was made on the railway company's books at Jamaica, or wherever they were kept.)

The Central Trust Company afterwards learned of the pledge of the stock to the Manhattan Trust Company, and immediately brought an action seeking to have the stock declared subject to the mortgage as a prior and superior lien, the certificates delivered to it, and the West India Improvement Company and the Manhattan Trust Company enjoined from making any sale or disposition of them. The court said in the course of its opinion:

"At the time the Improvement Company made the assignment to the Manhattan Trust Company, it delivered to that company the certificates of stock (which then stood in its own name) with transfers and powers of attorney endorsed on the certificates and executed by the assignor. If the railway company had been a domestic corporation and the transfer of its stock subject to the law which prevails in this state, it is clear that by the delivery of such certificates and transfers the Manhattan Trust Company would have acquired the legal title to the stock, as against every one except the railway company, and being a purchaser in good faith, for value, to the amount of the notes which were discounted for cash, would have held it free from any lien or claim of the plaintiff."

The court then proceeded to discuss the finding by the referee that by the law of Jamaica the legal title to the capital stock of the railway company, as between the Improvement Company and the Manhattan Trust Company, could pass only by deed of transfer and did not pass by the delivery of certificates with transfers in blank duly endorsed thereon, and proceeded as follows:

"Certificates of stock are neither choses in action nor negotiable instruments; but both in England and in this country it has been sought to render dealings in stocks practicable and to secure the rights of purchasers by giving to stock certificates attributes of negotiability to a certain limited extent. So the rule is settled in England that a purchaser in good faith without notice who succeeds

in obtaining his transfer to be first registered holds his stock free from the equities of other persons.

"If the instruments which the Manhattan Trust Company obtained from the Improvement Company before the advance of the money on the notes, were sufficient to enable the Trust Company by its own act or at its own volition to acquire a legal title to the stock, then upon such transfer on the books of the railway company the title of the Trust Company became indefeasible."

But the court did not attempt to decide whether in fact the title was indefeasible, as a new trial was necessary in any event.

In a case in the United States Circuit Court (Masurn v. Arkansas, 87 Fed. Rep. 38; citing Hammond v. Hastings, 134 U. S. 401, and other cases), it appeared that certain stock of an Arkansas corporation had been pledged in New York. Under the New York law the pledge would have been good, but under the Arkansas law its validity was doubtful. The court stated:

"Whatever the general principles of international law in relation to assignments of personal claims may be, the validity of a transfer of stock is governed by the law of the place where the corporation is created."

Although the liability of the issuing corporation was not in question in either of the cases just cited, it clearly follows from the rule laid down in each that ignorance or disregard of the law of a foreign state or country may result in wrongful or invalid transfer of stock there created. In such cases the issuing corporation would be liable for the consequences.

In a case decided by the Supreme Court of the United States in 1887, it appeared that stock standing in the name of A was transferred upon an assignment purporting to have been made by A through B as her attorney. The corporation knew that B had theretofore acted as the representative of A and did not require from him any clear proof that he was authorized to effect the particular transfer, honestly believing from his representations that he was so authorized. The proof not being sufficient to establish agency as a fact, the court was of the opinion that the issuing corporation was liable to reimburse the stockholders for the loss occasioned by its mistake in permitting the transaction.

As will be seen, this was a case where the negligence rendering

the issuing corporation liable consisted merely in the failure on the part of some one of its officials to investigate beyond question the authority of the apparent agent of the stockholder to transfer stock for that stockholder.

Mistake and actual negligence, however, seem to have been rare in the transfer of stock, and most of the cases where the issuing company has been subject to liability in connection with the acts of its transfer agent have arisen from fraud on the part of persons so employed. Of these cases the Schuyler frauds, which took place in 1853 and 1854, are the most notable, not only because of the extent of their consequences, but because in the enormous litigation which followed, the liability of the issuing corporation for the acts of the transfer agent was fully discussed and definitely settled.

The New York & New Haven Railroad had $3,000,000 capital, represented by 30,000 shares of stock. Schuyler, who was president of the company and its transfer agent, issued and disposed of additional certificates, falsely purporting to represent stock to the amount of $2,000,000, or 20,000 shares. The result was a protracted litigation, in which the holders of the overissue, more than 300 in number, were finally in a single action joined against the company. In the report of the proceedings in 1858, before the Court of Appeals, their various claims are described as follows:

"They all claim rights against the company: some that they are stockholders; others that they are either stockholders or have a right of action against the company for their losses. Some claim damages to the full nominal par value of the certificates they hold; others for the money they have actually advanced; while all assert a claim upon the company in some form."

After some years the case reached the Court of Appeals again, where it was finally held, in 1865, that a corporation is liable to the same extent and under the same circumstances as a natural person for the acts and for the negligence of its agent while engaged in the business of his agency, and that neither the fact that the agent was acting outside the terms of his actual authority, nor the fact that the stock so issued was void, nor that the company itself had no power to issue that amount of stock, was any defense to the claims of the holders, because the company had put its agent in a position to perpetrate the fraud while seeming to act within the scope of his

authority. (Mechanics' Bank v. New York & New Haven R. R. Co., 13 N. Y. 599; New York & New Haven R. R. Co. v. Schuyler, 17 N. Y. 30; New York & New Haven R. R. Co. v. Schuyler, Cross and 325 others, 17 N. Y. 594.)

The responsibility of the issuing company for the due registration and transfer of its own stock, as illustrated by the cases I have quoted, is briefly stated in the words of the United States Supreme Court, in another case, as follows:

"The officers of the company are the custodians of its stock books, and it is their duty to see that all transfers of shares are properly made, either by the stockholders themselves or persons having authority from them. If upon the presentation of a certificate for transfer they are at all doubtful of the identity of the party offering it with its owner, or if not satisfied of the genuineness of a power of attorney produced, they can require the identity of the party in the one case, and the genuineness of the document in the other, to be satisfactorily established before allowing the transfer to be made. In either case they must act upon their own responsibility. In many instances they may be misled without any fault of their own, just as the most careful person may sometimes be induced to purchase property from one who has no title, and who may perhaps have acquired its possession by force or larceny. Neither the absence of blame on the part of the officers of the company in allowing an unauthorized transfer of stock, nor the good faith of the purchaser of stolen property, will avail as an answer to the demand of the true owner."

The limit of the liability thus described by the United States Supreme Court is nicely determined in a decision of the Supreme Court of Massachusetts. In that case an executor pledged stock of the estate which he represented, as collateral for a loan to another. The Old Colony Railroad, the corporation which issued the stock, after ascertaining that the executor had absolute power of sale, recorded the transfer and issued a new certificate in the name of the bank making the loan. On default in the payment of the note, the bank sold the stock at auction. (Telegraph Company v. Davenport, 97 U. S. 369, at p. 371; Crocker v. Old Colony R. R. Co., 137 Mass. 417.) In an action subsequently brought to compel the railroad company to issue a new certificate for the benefit of the estate, it was

held that, although the act of the executor in transferring the stock as he did was fraudulent, the corporation was not bound to look beyond the power of transfer in order to find out the purpose for which the transfer was made.

The court said in part: "When a transfer of stock is presented to a corporation, it is bound at its peril to see that it is a genuine transfer by one who has power of disposition over the stock." And citing several Massachusetts cases on that point, the court continued: "If it issues a certificate upon a forged or unauthorized transfer, the real owner retains his property in the stock and the corporation may be liable to a bona fide holder of the new certificate. But when a transfer by one who has full power to transfer is presented, the corporation has the right to act upon it, and it is not its duty to inquire into the purposes of the parties or to investigate the question whether the transfer is in good faith or is fraudulent."

On the ground that it was not material to the issue, the court declined to discuss the question whether or not the corporation would have been liable had it possessed actual knowledge of the fraudulent purpose of the transfer, but from the other decisions which I have already cited, there is little doubt that that fact would have rendered it responsible for the loss.

On the other hand, to quote again from the Massachusetts Supreme Court, in the same case: "If a proper transfer is presented to a corporation, it is its duty to issue a new certificate in accordance with it, and if it refuses, it is liable to the person to whom the transfer is made." (Crocker v. Old Colony R. R., 137 Mass. 417.)

These cases serve to illustrate the liability of the issuing corporation. For all loss occasioned, whether by fraud, negligence, or unavoidable mistake, by it or its agents in the transfer of its stocks, such corporation is absolutely liable and no excuse can mitigate its liability.

How much of this responsibility attaches to the registrar and transfer agent, when they are separate corporations? While the officers of some companies which act as registrars undoubtedly believe that the responsibilities connected with the discharge of the office are not so great as are those of a transfer agent, that opinion is probably not generally held. According to the practice in New York, at least, a registrar seldom requires more than the exhibition

of a canceled certificate of stock for a given number of shares and the presentation therewith, either by the issuing corporation or by its transfer agent, of a new certificate for the same number of shares in the name of the transferee of the canceled certificate. Thereupon the registrar signs the new certificate without requiring other evidence of the correctness of the transfer. Now if, as a fact, the transfer agent has been induced to cancel the old certificate and to issue the new by a forged or otherwise invalid transfer, the stock does not follow the new certificate. In other words, the new certificate represents no stock. The countersignature of the registrar, which, in effect, certifies to the public that the certificate upon which it appears does not represent an overissue, would, therefore, in such cases be false and might be held to constitute grounds for a suit for damages.

This possibility is clearly brought out by an opinion dealing with the relation existing between a corporation and its transfer agent. (Fifth Ave. Bank v. 42d St. and Grand St. Ferry Co., 137 N. Y. 231.) The plaintiff in the case made a loan secured by the pledge of a certificate of stock. It developed that the secretary of the defendant company, who was also its treasurer and transfer agent, had forged the president's name to the stock certificate, and in his own official capacity had signed and countersigned the certificate and finally delivered it to his partner for the purpose of obtaining money for the firm. The issuing corporation refused to treat the certificate as valid, but was held liable therefor in an action for damages, at the suit of an innocent holder for value.

The court said: "This result follows from the application of the fundamental rules which determine the obligations of a principal for the acts of his agent. They are embraced in the comprehensive statement of Story in his work on Agency (9th ed., Sec. 452), that the principal is to be 'held liable to third persons in a civil suit for the frauds, deceits, concealments, misrepresentations, torts, negligences and other malfeasances or misfeasances and omissions of duty of his agent in the course of his employment.' "

Again—"It is true that the secretary and transfer agent had no authority to issue a certificate of stock except upon the surrender and cancellation of a previously existing valid certificate, and the signature of the president and treasurer were first obtained to the

certificate to be issued; but those were facts necessarily and peculiarly within the knowledge of the secretary, and the issue of the certificate in due form was a misrepresentation by the secretary and transfer agent that these conditions had been complied with and that the facts existed upon which his right to act depended. It was a certificate apparently made in the course of his employment as agent of the company and within the scope of the general authority conferred upon him, and the defendant is under an implied obligation to make indemnity for the loss sustained by the negligent or wrongful exercise by its officers of the general powers conferred upon them."

The court further said: "The in testimonium clause asserted that the defendant had caused that particular certificate to be signed by its president and countersigned by its treasurer and transfer agent and sealed with its corporate seal February 6, 1885. It is very clear that under the regulations adopted by the defendant, and pursuing the mode of procedure which it had prescribed, the final act in the issue of a certificate of stock was performed by its secretary and transfer agent, and that when he countersigned it and affixed the corporate seal and delivered it with the intent that it might be negotiated, it must be regarded so long as it remained outstanding as a continuing affirmation by the defendant that it had been lawfully issued and that all the conditions precedent upon which the right to issue it depended had been duly observed. Such is the effect necessarily implied in the act of countersigning. This word has a well defined meaning both in law and the lexicon. To countersign an instrument is to sign what has already been signed by a superior to authenticate by an additional signature, and usually has reference to the signature of a subordinate in addition to that of his superior, by way of authentication of the execution of the writing to which it is affixed, and it denotes the complete execution of the paper." (Citing Worcester's Dictionary.) "When, therefore, the defendant's secretary and transfer agent countersigned and sealed this certificate and put it in circulation he declared in the most formal manner that it had been properly executed by the defendant and that every essential requirement of law and of the by-laws had been performed to make it the binding act of the company."

In this case, it is true, the action was brought against the corporate principal and the question before the court was not that of the

liability of the officer in countersigning. While, therefore, the language of the decision cannot be taken as authority on the latter subject, it conveys a warning that in countersigning a certificate a registrar does rather more than certify the due formality of execution, and at least suggests that the registrar, in addition to the issuing company, would be liable for any damage that might be occasioned thereby.

Let us now proceed to consider the liability of a trust company acting as transfer agent.

In the first place, the position of the issuing corporation to the stockholder differs essentially from that of the agent to the principal. The corporation, by its contact with its stockholders, grants them certain absolute rights which cannot be affected by the fraud, negligence, or mistake of its agents. The agent, on the other hand, promises the principal that it will do a certain thing, and this promise the general law of agency qualifies by confining it within the limits of ordinary human prudence and ability, unless express provisions to the contrary are contained in the contract itself. The transfer agent must, of course, follow the instructions of its principal loyally, in good faith, and with reasonable care and diligence.

Loyalty and good faith need no definition, while the care and diligence required by law from an agent in the discharge of his agency has been stated by the courts to be —"the same degree of care that men of ordinary prudence exercise in regard to their own affairs," and so it has been held, in a case just decided in the highest court of this state, with regard to directors of moneyed corporations in performing corporate business.

Under these general rules of agency, the responsibility from which the trust company, acting as registrar and transfer agent, relieves the issuing corporation is apparent. The trust company assumes the task of providing and supervising men of integrity and ability to perform the duties of registration and transfer, and the liability for loss resulting from the actual negligence or dishonesty of its employees. If Schuyler, for example, had been the officer of a trust company acting as transfer agent, that trust company would in all probability have been held liable to the New York & New Haven Railroad for all the loss occasioned by his acts, and the railroad company would have lost nothing, had the assets of the trust

company been sufficient to meet the liability. Moreover, the chance is small that in such an event the loss would have occurred.

Transfer agency is a part of the regular business of the trust company—a specialty in which it has constant practice and over the details of which and the men engaged therein it must exercise active and intelligent supervision. In short, the trust company has skill, practice, and system; its temptation to do right is greater than its temptation to do wrong; it is financially responsible and cannot escape the jurisdiction. The law, too, has hedged it with safeguards in its own interest and the interest of its clients. (Hanna v. Lyon, 179 N. Y. 107.)

It would seem that these conditions sufficiently meet the needs for which corporate transfer agents were required; but apparently a doubt has somehow arisen that their liability is bounded by the law of agency, and it has been suggested that they are saddled with the whole responsibility of the issuing company to its stockholders, involving the duty of absolute infallibility, and liability for the consequences of any mistake, however unavoidable, and in spite of the exercise of any degree of care and diligence.

On two occasions[1] there have been read before this section of the American Bankers' Association papers upon the duties and responsibilities of a trust company acting as registrar and transfer agent. The earlier of them argued that the liability involved in the discharge of the functions of the transfer agent was measured by its negligence, but that in the capacity of registrar the liability was not so limited. The later paper, avowedly prompted by the earlier one, urged that the measure of liability was the same in each of the two representative positions, and that the liability extended beyond that of the ordinary agent; in other words, that the contract between the trust company and the issuing company is, in effect, that the trust company will save the issuing company harmless from all improper issues and transfers, whether the exercise of the utmost care would have prevented the mistake or not. Whether this guaranty was confined to the company whose stock or bonds were the subject of transfer, or extended to the lawful owners of the securities, was not definitely stated by the author of the article; but it was evidently his opinion that should the courts be called upon to deal with the ques-

[1] The first paper was presented by Felix Rackemann, of Boston, August, 1898. The latter will be found on page 507 of this volume.

tion, they might well hold a transfer agent liable to persons interested in the stock or bonds for any injury sustained through an improper transfer or registration. This opinion drew forth observations from representatives of trust companies indicating that their views of the responsibilities assumed by trust companies acting in either capacity had been correctly voiced in the article.

While every member of the bar who has given to these questions any consideration must have definite views as to the principles of law applicable to the duties of the office and the measure of responsibility involved therein, any attempt by me to justify the conclusions reached in either of the papers referred to would be idle at this time. But reflections upon the method by which trust companies can be adequately protected in acting in either capacity, reflections suggested by the diversity of views entertained by the two able writers of those papers, may be of present value.

The object of the usual rule that stock "shall be transferable only upon the books of the corporation," was and is simply to settle the ownership of stock beyond dispute by putting in the hands of stockholders and the corporation accurate and authoritative evidence of title, somewhat like that which the law has created in the case of land, the portable evidence being supplied by the stock certificates as by the deed, and the record by the stock books as by the books of the register of deeds. Further, owing to the relation between the stockholders and the corporation, involving the right to vote and receive dividends, it was deemed wise that stockholders should not be permitted to bind the corporation by independent transfer, however they might bind themselves. From these causes arose the need of the formal transfer, the surrender to the corporation of the old certificate, the issue by the corporation of the new certificate, and the entry of the transaction upon the corporate books.

Originally these details of transfer were treated as mere incidents to the business of the corporation whose stock was to be transferred, and, as such, were performed by one or other of its officers or employees, discharging other duties as well. Now in many instances this portion of a company's business is entrusted to another corporation, though this is not in any case necessary, provided there be an independent registrar. The old by-law of the Stock Exchange providing "The Stock Exchange will not call or deal in any active

speculative stock of any company, a registry of whose stock is not kept in some responsible bank, trust company, or other satisfactory agency," while it suggests banks and trust companies as proper registrars, does not necessarily prohibit a corporation from keeping its own transfer agency, nor does the article of the constitution of the Stock Exchange, by which the old provision is superseded; namely: "Corporations whose shares are admitted to dealings upon the exchange will be required to maintain a transfer agency and a registry office in the City of New York, Borough of Manhattan;" and: "Both the transfer agency and the registrar must be acceptable to the committee on stock list, and the registrar must file with the secretary of the exchange an agreement to comply with the requirements of the exchange in regard to registration." (Old by-laws of New York Stock Exchange, Art. IV., superseded by present constitution, Art. XXXIII.)

It therefore seems fair to assume that the reason for the general adoption of independent corporate transfer agents is the purely natural one before suggested; namely, the additional security to the issuing corporation and its stockholders which comes from the services of a responsible agent making this most important function a recognized part of its regular business, over that afforded by the old system with its burden of detail and risk. Trust companies are by the law of New York, and of other states as well, specifically authorized to act as transfer agents and registrars.

From this brief review of the situation of issuing companies as regards the transfer of their stock, the probable origin of the office of independent corporate transfer agency and registry, and the diverse theories of the obligations and liabilities assumed by a trust company in acting in each capacity, we are naturally led to consider the protection of the trust company from the viewpoint of those believing in the greatest measure of liability. Assuming, then, for the purpose of our discussion, the twofold nature of the obligation imposed upon trust companies acting as transfer agents; namely, their liability as agents for negligence and fraud, and the greater liability, amounting to insurance, to appreciate more clearly what it involves, let us consider a specific instance of the obligation.

Take the case of the United States Steel Corporation, with its enormous capital stock of $1,100,000,000, of which $508,302,500 of

common stock and $360,140,000 of preferred stock are outstanding. The Hudson Trust Company was specifically organized to act as the transfer agent of all the stock; the New York Security & Trust Company was designated the registrar of its preferred stock, and the Guaranty Trust Company of its common stock. Now, if the real obligation assumed by these three trust companies is what we have assumed for the purpose of argument, there would be a contingent liability thereby created for no less an amount than $868,442,-500, the sum total of the outstanding stock, the validity of which the Hudson Trust Company as transfer agent, and the New York Security & Trust Company and the Guaranty Trust Company, as registrars have insured; subject, of course, to abatement through fluctuation in the market value of the securities, and, in the last analysis, a contingent liability not even limited by the stupendous sum represented by those securities.

There is no trust company that we know of which could legally assume such an enormous liability on a single risk. As is well known, depositors and beneficiaries whose funds are entrusted to trust companies are jealously protected by statutory safeguards. Only approved investments are authorized, and the legal reserve must be faithfully maintained. To incur, therefore, in a single transaction, such an insurance liability, is obviously a clear violation of all principles of business and legal prudence, which have persistently aimed at the largest security for the public consistent with sound banking methods. By the law of New York there is only one class of corporations authorized to assume such an insurance risk, namely, insurance companies.

Casualty insurance companies may guarantee "the performance of contracts other than insurance policies," and may guarantee "the validity and legality of bonds issued by . . . any private or public corporation." (Gen. Laws of New York Insurance, Sec. 70.) Moreover, along with the authority so conferred, the insurance law imposes stringent limitations, quite distinct from those to which trust companies are subjected. For the protection of the insured and the general public, it is provided that no single risk shall be taken by an insurance company in an amount exceeding one-tenth of its capital stock and surplus, except where it is secured by collateral, which, of course, by so much lessens the actual risk. (Gen. Laws of New York, Insurance, Sec. 24.)

It would seem, therefore, that, reverting to our illustration and proceeding on our assumption of the theory of insurance or guaranty, the Hudson Trust Company, the New York Security & Trust Company, and the Guaranty Trust Company, in undertaking to act as transfer agent and registrars respectively of the United States Steel Corporation, violated the letter or the spirit of the insurance law, for the capital and surplus of the Hudson Trust Company (a corporation organized under the laws of New Jersey, where there is a similar statute limiting the amount of authorized insurance) is only \$1,440,075.71; of the New York Security & Trust Company, only \$12,239,945.70; and of the Guaranty Trust Company, only \$7,125,-856.99, making in the aggregate \$20,805,877.40, or about one-forty-second of the amount of the par value of the securities of the Steel Corporation. If to the ordinary liability as agents proper, for negligence and misconduct, trust companies so acting have assumed the extraordinary liability of insurance or guaranty, the possible beneficiaries thereof are substantially the issuing corporations or the general investing public, as represented by the Stock Exchange. Now it cannot be conceived that either the investing public, the Stock Exchange, or the issuing corporations can be well protected, if at all, by the assumption by trust companies of this extraordinary liability of guaranty, which, in the case of every large issuing corporation, not only violates the insurance law, but by subjecting the entire capital of the company to the hazard of a single risk, runs counter to all principles of ordinary business prudence as well.

The interest of the issuing company remains to be considered. It is, of course, liable, in any event, to those interested in its stock who may be injured by its own acts or those of its corporate transfer agent or registrar. The trust company is appointed by and receives its compensation from the issuing corporation. It would be appropriate, therefore, in a proper case, for the issuing corporation to insure itself in a responsible company in a manner provided by law, against claims to be made against it on the ground of the invalidity of the stock, bonds, or other securities it assumes to issue. Whether we consider the proper function of a trust company, which is not that of insurance, or the measure of the compensation received for acting as transfer agent or registrar, which bears no relation to the insurance risk, it results that an issuing corporation should seek

such security, not from the trust company, but from a company authorized and equipped to write insurance, and properly paid therefor.

Having considered the possible results of an insurance obligation on the part of trust companies occupying such relations, and demonstrated, it is believed, the undesirability of such a status, the question that confronts us is whether the situation admits of remedy. An obvious but doubtful solution would be the separation of the responsibility, giving to trust companies ordinary liability for their own negligence or fraud, and to insurance companies the extraordinary hazard incident upon insurance. It is believed, however, that the trust companies have answered the purpose of registrars and transfer agents so well that there would be no disposition on the part of the issuing corporations to incur additional expense in procuring insurance from insurance companies. A solution based upon such a separation of functions would, therefore, probably prove impracticable.

When the ingenuity of business is unequal to the task of avoiding an oppressive liability imposed by law, it is usual to find the solution where logically it belongs—in the change of the unsound law. If, then, this insurance liability attaches to the contract entered into between trust companies and the issuing corporations, for the benefit of the issuing corporations or the public at large, and, in fact, is a responsibility which the trust companies are neither authorized by law to assume nor justified by business sagacity in incurring, and for which the trust company is not compensated; and further, if this extraordinary liability of the trust company results in only illusory security to the issuing corporations and the public at large, it must surely follow that every interest involved should seek relief in changing the law, which is seemingly to the present advantage of nobody, and which is therefore unreasonable. It would seem that the necessary legislation could be readily obtained. Its sole purpose would be to clarify the legal relation of trust companies when acting as transfer agents or registrars, a relation that at present is confessedly and dangerously obscure. Not a single interest could possibly be injured thereby. The liability of the issuing company to all interested in its stock would remain as at present, while the trust company in the capacity of transfer agent or registrar would be

relieved from any liability save for the negligence or willfully wrongful acts of its officers, either in connection with the stock, bonds, or other certificates of indebtedness of the principal corporation, or in the selection or continued employment of incompetent clerks. Such a law would not impose upon the issuing corporation any other or different liabilities or obligations from those to which it would be subject should it act as its own transfer agent or have as its registrars individual employees; but would permit them to be relieved, as now, from a vast amount of clerical detail. Moreover, they would be assured that the transfers of their stock would rest in the hands of those peculiarly competent, from large and continuous experience, to throw every safeguard around the transfers, and would be relieved from the onerous responsibility of constant and active supervision.

By Section 156 of the banking law of New York, trust companies are empowered to "act, as the fiscal or transfer agent of any state, municipality, body politic, or corporation; and in such capacity to receive and disburse money, to transfer, register and countersign certificates of stock, bonds or other evidences of indebtedness, and to act as agent of any corporation, foreign or domestic, for any lawful purpose." I would propose, as an amended statute, which I believe would achieve the desired result, a law of the following character:

"Section 156. Powers of Corporation. Upon the filing of any such certificate of authorization of a trust company, the persons named therein and their successors shall thereupon and thereby become a corporation, which, in addition to the powers conferred by the general and stock corporation laws, shall have power—

"1. To transfer, register, and countersign certificates of stock, bonds, and other evidences of indebtedness of corporations, with liability to such corporations and to the owners or holders of such certificates of stock, bonds, or other evidences of indebtedness, solely for the negligence or willful misconduct of its officers in reference to such certificates of stock, bonds, or other evidences of indebtedness, or in the appointment or employment of its agents, clerks, or employees dealing therewith.

"2. To act as the fiscal or transfer agent of any State, municipality, or body politic."

There should, in my opinion, also be an additional provision

making the limitation of liability apply to existing trust companies, whether incorporated under general laws or special acts. There seems no reason why a like modification of corporate transfer liability may not be accomplished in other states in much the same manner.

POWERS OF FIDUCIARIES OUTSIDE THE STATE OF THEIR APPOINTMENT

ADDRESS DELIVERED BY FREDERICK VIERLING, TRUST OFFICER OF THE MISSISSIPPI VALLEY TRUST COMPANY, ST. LOUIS, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT MILWAUKEE, OCTOBER, 1901.

IN this paper the consideration of the question indicated in the title will be limited, relating only to express trusts legally created and not contravening the law against perpetuities and duly accepted by the fiduciary; the discussion not touching in any way the many points of difference arising out of implied trusts and illegal trusts, so called, or matters of agency.

We are all familiar with the character of the different kinds of trusts and the offices of fiduciaries known as executor and administrator, guardian or curator, receiver, assignee, and trustee. As a general rule, all natural persons capable of confidence and of taking and holding either the legal title or a beneficial interest in property may hold it in trust for others; and corporations may hold property and execute trusts where this power is within the scope of their corporate existence, such as trust companies, which are given comprehensive powers to execute trusts of every description.

The subject naturally divides itself into the following three points of discussion, to wit:

1. Where the fiduciary is the natural person and the trust company is created: (a) by act of the parties such as trusteeships and assignments; and (b) where the trust is created by appointment of the various courts under the law having jurisdiction in the premises, such as guardianships and curatorships, receiverships, administrations, and executorships, the latter being under probated wills nominating an executor, who is appointed by the court to execute

the will, and deriving his powers from both the will and the law;

2. Where the fiduciary is a corporation authorized by law to accept and execute trusts; and

3. Where the property of the trust is personalty and where it is real estate.

It is one of the attributes of the ownership of property that the owner has power to dispose of it as he chooses, so long as he does not trespass on the rights of others or act in a way contrary to law. It is a well-established right, among others, that the owner may by a conveyance in trust create a trust of his property for the various purposes with which we are familiar, to take effect during his lifetime; or by will he may create a trust independent of the duties of his executor, to take effect after his death. Either of the trusts so created is by act of parties, and the trustee has all the powers over the trust property that may be delegated to him by the owner, and the power of the trustee over the trust property in another state is the same as in the state where the trustee resides. Under our national Constitution the citizens of each state are entitled to all the privileges and immunities of citizens in the several states; and under this provision a citizen of one state may acquire, own, and dispose of property in another state just as can a citizen resident in that other state; and our national Supreme Court has repeatedly decided that this provision applies equally where the property is conveyed to a non-resident trustee in trust.

Another fiduciary relation created by act of party is where a debtor assigns all his property for the benefit of his creditors. As a general rule, the assignee need not be a resident of the state where the property is situate, and takes the title to all property of his assignor wherever found; the assignee becomes the legal owner of the property and has the same power and control over it as if he were the absolute owner. This general rule must be qualified, as where the laws of the foreign state where some of the property is provide for statutory assignments only, thus prohibiting general assignments other than statutory; in such cases the general assignee cannot assume charge of the property in the foreign state without complying with the statutory requirements and conditions, and if the assignee must be a resident he cannot obtain recognition at all. Assignments are still permitted under the state laws, though

under the national bankruptcy act an assignment is an act of bankruptcy, and the debtor's matters on application of any person interested will be taken charge of by the bankruptcy court and the assignee be ousted. Questions relating to assignments therefore are no longer of greatest importance.

Where the fiduciary is appointed by the various courts under the law having jurisdiction, as trusts for minors and insane persons, receiverships and administrations, the appointment in contemplation of law is not by voluntary act of party. These are instances where the courts step in and appoint legal representatives for owners to protect their property interests, where they themselves have no legal capacity, as guardians or curators; or where there is danger of waste and the conflicting interests are involved, as receivers; or where the owner is dead, as administrators and executors. In law these legal representatives are considered officers of the courts, and, as these courts have complete jurisdiction only in their own states, they can give their officers no greater territorial power than their own, and the appointment of such officers has no effect on property beyond the territorial limits of the state in which the appointment is made. (In some of the states citizens of another state may be appointed, and in such cases the foreign representative has the same powers as a citizen of that state would have if appointed.) The general rule is modified to some extent, as follows:

As to administrators and executors, by the principle that they, as such, are the legal representatives of the deceased owner in control of all his property and may collect assets in a foreign jurisdiction if payment or delivery is made to him voluntarily, so that resort to the foreign courts is not necessary; or where the foreign statutes in a spirit of comity give the domiciliary administrator or executor power to act.

As to guardians, etc., upon principles of comity, the authority of a guardian appointed in the state of the ward's domicile will sometimes be recognized by the courts of other states, and in some states statutes have been enacted enabling foreign guardians of non-resident wards who have property in the state to obtain authority to act in reference to such property or to remove it from the state.

As to receivers, it is well settled that they will be permitted to sue and act in jurisdictions other than where they are appointed, where this will not result in the violation of any principle of public policy or law.

The fiduciaries we have spoken of in this general way are natural persons. The general principles heretofore indicated must be further modified when applied to corporate fiduciaries. A corporation, so far as its inherent power to do the business authorized by its charter is concerned, can engage in business anywhere, and is not limited by the bounds of the state of its organization, or prohibited from doing business in other states, unless the laws or public policy of such other state deny it the right. It has been said a corporation can have no legal existence beyond the bounds of the state by which it is incorporated and can exercise none of the privileges conferred by its charter in any other state except by comity and the consent of the latter. Comity is presumed to exist and does exist until a state expresses an intention to the contrary in some affirmative way, by direct enactments on the subject, or by its public policy deduced from the general course of legislation, or by settled adjudications of its courts of last resort. Our national Supreme Court has said that corporations of other states are not "citizens" within the meaning of the clause of our Constitution above referred to. It follows that a state may discriminate in favor of its own corporations against corporations of another state. Our states have quite generally adopted laws regarding foreign corporations, permitting them to do business under restrictions more or less severe.

In contemplation of law, personalty is situate at the domicile of the owner, though actually at some other place; and if the property of the trust is personalty, it is a general principle that a transfer to the fiduciary, valid according to the law of the domicile of the grantor, will be recognized in the state where the property may actually be. In all cases the validity and effect of conveyances of real property is determined by the laws of the state where the property is situate; these vary as to forms of conveyances and acknowledgments required, and the only rule is in each instance to follow the statutory requirements of the several states. In some

states corporations are not permitted to hold real estate, and in such states a corporate fiduciary could not take and hold title.

I have looked over the statutes of the various states for enactments regarding the several classes of foreign fiduciaries, touching upon their right to do business in the several states, I find that practically all the states permit foreign corporations under restrictions to do business generally, but not all provide for corporate fiduciaries. Where the state knows no corporate fiduciary under its own laws, it is almost safe to conclude that foreign corporate fiduciaries will not be recognized, as, on principle, a state will not allow a foreign corporation to do an act within its limits that it does not permit its own corporations to do.

Most of the states by enactments permit foreign executors, administrators, and guardians to represent their trusts in the state under various restrictions, usually requiring bond and proof of their appointment in the domiciliary state, but sometimes permitting them to do only specific acts. There are but few states whose statutes deny such foreign fiduciaries any recognition. As to foreign assignees, receivers, and trustees, the statutes are for the most part silent. From the trend of legislation there is a marked spirit of comity between our states, which I am indeed glad to see. In many instances it means the proper business management of a trust by one fiduciary familiar with all the affairs of the estate. This is of great importance to the beneficiaries, saving double court costs and fiduciary fees, and enabling the one fiduciary to derive for the beneficiaries the incalculable benefits of a harmonious and uniform management of the whole estate, just as in the case of the former owner himself. I am an advocate of even more liberal laws on the line of the recognition by other states of fiduciaries of sister states than we find at present; and as no beneficiary or creditor of an estate is denied the privilege of redressing his wrongs, whether he be a resident or non-resident of the state, there is no sound reason why there should be any hostility whatever toward foreign fiduciaries properly appointed under reasonable regulations as to giving bond and the performance of their duties.

THE POWER OF ATTORNEY FROM EXECUTORS AND TRUSTEES, FROM THE VIEWPOINT OF THE DEPOSITARY

ADDRESS DELIVERED BY JORDAN J. ROLLINS, OF THE NEW YORK BAR, BEFORE THE NEW JERSEY BANKERS' ASSOCIATION AT ATLANTIC CITY, MARCH, 1905.

THERE is a prevalent opinion among the officers of banks and trust companies, at least in the city of New York, that any depositary which recognizes a power of attorney from an administrator, executor, or trustee authorizing another to draw checks upon a trust account, thereby incurs an unwarranted responsibility. As the question whether it is safe to recognize such a power of attorney is a practical one, which all of you may in due course be called upon to decide for yourselves, it may interest you to have submitted at this time some principles which will aid you in reaching a correct decision in the premises.

Obviously, every depositary, recognizing the advantage to itself which lies in accommodating its customers, desires to facilitate them in the despatch of their business in every way consonant with safety. And this desire must obtain in connection with estate accounts, which often are maintained for considerable periods of time, and not infrequently reach figures of magnitude.

Curiously enough, there seems to be no judicial decision reported in the books dealing with the question which we are to discuss, and in the discussion of which we shall use the word "trustee" as including administrators, executors, and trustees, whether appointed by testament of instrument inter vivos, unless the context clearly indicates a contrary intention.

In determining what a depositary may safely do when confronted with a trustee's check, drawn by attorney, upon the estate account. two things are to be considered: first, the extent of the right of a trustee to give a power of attorney for that purpose; and, second, the position of the depositary in the premises, and the extent of its duty or right to inquire into or interfere with the acts of a trustee dealing with the trust deposit account.

First, let us consider the authority of the trustee. Obviously, the only objection to the conduct of a trustee in delegating to others any of the duties connected with the performance of his trust lies in

the fact or theory that by his appointment a special confidence has been reposed in his personal qualifications, and that by employing another to do what he has been entrusted to do he betrays that confidence. The law, accordingly, has laid down the rule embodied in the old maxim, "delegatus non potest delegare," literally, "one delegated cannot delegate"; that is to say, he who is appointed to do a thing for another may not himself appoint another to do it.

The person who designates a trustee, as well as the court which finally authorizes him to act, generally relies upon his having three qualifications—pecuniary responsibility, integrity, and ability.

So far as pecuniary responsibility is concerned, it is quite clear that there can be no betrayal of confidence on the part of the trustee in employing an agent or attorney to act for him in the performance of the duties of the trust. If the trustee is insolvent, and has given no bond, he is equally insolvent whether he acts in person or by another; indeed, in acting by another he may render the beneficiary more secure, for the agent may be solvent, and if he be in fault, liable for the loss occasioned thereby.

Lack of integrity is often guarded against by bond, and, in general, a sufficient bond eliminates that element from consideration. But where there is no bond, the question of the trustee's integrity and the delegation of his power to another become, in fact, of vital importance. And yet, if the trustee exercise his own integrity in the premises by requiring and obtaining from the agent whom he employs adequate security for the estate in the form of a bond or indemnity, or in the character and resources of the agent, the trustee does not betray the trust in his own integrity. On the contrary, he justifies it by affording the beneficiaries security in addition to what they had before.

Ability, however, cannot be adequately supplemented by pecuniary arrangements, and where the act to be done requires the exercise of discretion, knowledge, or skill, the beneficiary has the right to have the duty performed by the trustee himself.

It would, therefore, seem that as a general proposition the interests of the creator of a trust and of the beneficiaries are prejudiced by the delegation to an agent of the powers of the trustee, only where the power delegated involves the exercise of those personal qualities for which the trustee has been chosen; that such

qualities may be summed up under the heads of personal integrity and special personal ability; and that the former becomes comparatively unimportant where independent of it the beneficiaries are amply secured for the proper execution of the trust.

In determining the extent of the right of a trustee to delegate to others the performance of acts in furtherance of his trust, the courts have followed the plain dictates of reason. Their decisions on the subject may be summed up as follows: Where the essence of the trust is that the trustee shall do certain acts himself, in person, he may not employ another to do them. Where the essence of the trust is merely that he shall cause certain things to be done, in doing those things he may employ for the purpose any proper person as his agent or attorney. And to this may be added the obvious proposition that where it is necessary, or unmistakably beneficial, to the performance of the trust, the trustee should act by agent or attorney; for in such case to refrain from so doing would defeat, instead of furthering, the object of the trust.

The case of Keim v. Lindley,[1] decided in the Court of Chancery of New Jersey in 1895, contains an admirable exposition of the principles by which the law determines the right of a trustee to act by agent or attorney. In that case it was held that trustees with a discretionary power to sell could not delegate that discretion to another, but, having exercised the discretion and determined to sell, and fixed a price, they might authorize an agent to contract in their names upon those terms. To quote from the opinion of the court:

"The rule invoked is that a power involving the exercise of personal discretion and judgment cannot be delegated." . . . "An examination of the authorities shows that the prohibition is against the delegation of the personal discretion and judgment. But, if the trustee or donee of the power actually exercises the discretion and judgment in a reasonable manner, and arrives at a conclusion, he may delegate to another the mere ministerial duty of carrying out that judgment. Mr. Lewin (page 258) says: 'It must be noticed that the appointment of an attorney or proxy is not in all cases the delegation of the trust. When the trustee has resolved in his own mind in what manner to exercise his discretion, he cannot be said to delegate any part of the confidence if he merely execute the deed

[1] Keim v. Lindley, 30 Atl. Rep. 1063, at p. 1074.

by attorney or signify his will by proxy.'" . . . "In 1 Perry on Trusts, Sec. 409, the learned author, speaking of the delegation of discretionary trusts, says: 'But it must be observed that the appointment of an attorney, proxy, or agent, is not necessarily a delegation of the trust. The trustee must act at times through attorneys or agents, and if he determines in his own mind how to exercise the discretion, and appoints agents or instruments to carry out his determination, he cannot be said to delegate the trust, even though deeds or other instruments are signed by attorneys in his name. So, if he gives instructions to his attorneys and agents how to act, it cannot be said to be a delegation of the trust.'"

The court quotes further from Hill on Trustees (p. 541) as follows: "'However, the employment of an agent for carrying out mere ministerial acts—such as the sale of the property, and purposes of that nature—is not within this rule, for such acts are necessary to the discharge of the trust, and it will be sufficient that the trustee retains the supervision and control over the persons so employed.'"

In a case decided in the Supreme Court of New York, in the first department, at general term, in 1890,[1] where a trust company, as guardian of infants, had employed an agent to collect rents, Presiding Justice Van Brunt said:

"It was clear that the trust company was entitled to employ agents for the collection of these rents, and, having that legal right, they could lawfully pay for the services of such agents. The point made by the appellant seems to be that the defendants were collecting rents upon their own account. But it appears that the trust company, as guardian of the infants, was in reality managing the estate, and as such had a right to employ all suitable agents."

A most lucid and thorough discussion of the extent of a trustee's power to act through other persons is contained in the report of a case decided in 1883 in the English Supreme Court of Judicature, Chancery Division.[2] Sir George Jessel, Master of the Rolls, said, in the course of his opinion:

"In the first place, I think we ought to consider what is the liability of a trustee who undertakes an office which requires him to make an investment in behalf of his cestui que trust. It seems to

[1] Garvey v. Owens, 12 N. Y. Supp. 349, 350.

[2] Spright v. Gaunt, 22 Ch. Div. 727, 739, 742.

me that on general principles a trustee ought to conduct the business of the trust in the same manner that an ordinarily prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee. In other words, a trustee is not bound, because he is a trustee, to conduct business in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt further and better precautions than an ordinarily prudent man of business would adopt, or to conduct the business in any other way. If it were otherwise, no one would be a trustee at all." . . . Lord Hardwick was quoted as saying: "But where trustees act by other hands, either from necessity or conformably to the common usage of mankind, they are not answerable for losses," the Master of the Rolls adding, "That, of course, means where they act by other hands, and properly choose the hands by which they act."

Moreover, under modern conditions, it cannot be said that a person, in selecting trustees, relies upon their personal performance of all the duties. A trust company, for instance, acting as trustee, can never give its personal services, for a corporation can act only through its agents. A man of business, as business is conducted to-day, is often in like predicament. The men, of all others, apt to be selected for offices of trust are those who are engaged in the successful management of large affairs. Such men do not and cannot attend in person to details. If they attempted to do so, they would utterly fail to accomplish the large enterprises which they now conduct with success. The very essence of the competency which renders them especially fit for the administration of trusts is the ability to secure and use the services of competent and trustworthy agents and employees. It is this which the creator of the trust expects from the trustee. A contrary theory would prevent corporations and individuals, who conduct their business upon large modern lines, from acting as trustees.

It is clear, then, in law, as well as in fact and reason, that at times trustees should act through agents, and that such a course is not, except under special circumstances, a betrayal of the confidence of the trustor. Why, then, should a trustee not delegate the author-

ity to draw checks upon the estate account? Is it a discretionary rather than a ministerial act?

Let us assume a case which is not unlikely to arise: A testator believes that his estate will be best managed after his death by his friend B. In forming this conclusion, he relies on the results that B has obtained in the conduct of his own business, and on his reputation for integrity and ability. B is a man of large affairs. He commands a large staff of employees, and his ability actually consists in getting the best possible work out of the best possible men. During his executorship he is called abroad, it may be in the interest of the testator's estate, to prove title to foreign property. In his absence it is necessary that someone be on hand to attend to the management of the estate at home. There is property to be preserved and cared for; there are current expenses to be paid out of the funds of the estate; it may be that there is more to do than any one man can do, that a number of persons must be employed and paid from time to time, and that it is impossible to foresee with accuracy what the necessary current expenses will be. He must leave an agent in charge, and that agent must be able to draw for certain purposes upon the funds of the estate. It appears to be clear that in such a case it would be not only the right, but the duty, of the trustee to appoint a proper agent, empowered to do these things, and that such appointment would be the best and only possible exercise of the trustee's discretion in the interest of the beneficiaries.

It is true that in authorizing another to draw against the credit of the estate the trustee places the trust money in another's actual control; and it may be argued that this is a breach of his trust, because confidence has been placed not only in his ability and discretion, but in his personal integrity in handling these moneys. But it should be remembered that a trustee must, in almost any conceivable case, leave the property of the estate under the actual physical control of other persons. If he employs an agent to collect rents, or a broker to purchase securities, or a depositary for specific valuables, or a caretaker in charge of a furnished house, he is necessarily placing property of the estate in the hands and physical control of third persons, and he can only give the estate the benefit of his personal integrity in such cases by refraining from fraud, and, to the best of his ability, appointing to handle the property persons

who will do likewise, instructing them strictly as to what is to be done.

Finally, to sign and present checks, receive money and apply it in certain specified ways and amounts, is, apparently, a purely ministerial act, does not appear to involve the exercise of the personal discretion sought from the trustee, and may, therefore, properly be delegated. It is clear, then, that the trustee's power of attorney for the purpose of signing checks is not in itself improper, and, on the other hand, may be beneficial, or even necessary, to the trust.

Now who is to determine at the time whether such a course is better or worse for the estate? The trustee, naturally, for he is appointed for that very purpose—to exercise his best judgment for the benefit of the estate.

Let us now consider the point more directly at issue—the position of the depositary. Ordinarily, of course, the bank or trust company receiving moneys to be credited upon a deposit account, and drawn upon by check, is simply the debtor of its depositors.[1]

That the same relation of debtor and creditor obtains between the depositary and a trustee was finally recognized by the New York Court of Appeals in the somewhat recent case of O'Connor v. Mechanics' Bank.[2] In the course of the opinion we find the following:

"As the legal title to the personal property [the property left by the testator] before it was sold, was in the executors, so the legal title to the proceeds of the sale was in them. When they deposited the proceeds in the bank, however, the title to the money passed to defendant, which impliedly promised to pay the debt thereby created by honoring the checks of the depositor as they were presented. Thenceforward the relation of the bank to the executors was that of debtor and creditor only. In a legal sense, the executors had no money in the bank, but simply a debt against the bank for the amount of the deposit."

This decision seems to be in strict conformity with the facts, with reason, and with the actual course of business. Consider what

[1] The Aetna National Bank v. the Fourth National Bank of the City of New York, 46 N. Y. 82.

[2] 124 N. Y. 324, 330. See also National Bank v. Insurance Co., 104 U. S., 54 to 63.

really takes place. The trustee is the person appointed to manage the estate, to hold and administer the property until the trust is fulfilled. The depositary is not. Nobody has requested it to interfere in any way in the care or management of the property, nor has it offered or agreed to do so. If the deposit was made by a person, since deceased, the trustee is his representative, and, so far as the bank is concerned, has simply become its creditor instead of the deceased. The case is the same if the deposit has been made by a person still living, who has created a trust and put property, including the credit arising from the deposit, in the hands and under the control of a trustee. If the funds are deposited by the trustee in his official capacity, he merely opens an account with a bank for his convenience in managing the estate. He does not delegate to the bank any of his duties, or any of his control over the credit substituted for the moneys deposited.

There, therefore, seems to be no good ground for the assumption that a depositary, in taking a deposit of trust funds subject to check, or in retaining an account upon which a trust has been imposed by the death of a depositor, or otherwise, assumes any additional duty, obligation, or responsibility, or acquires any rights beyond those existing in the usual course of its business with its depositors. Plainly, it can become liable to the beneficiary only through some fault of its own. This fault may occur either through a refusal to pay to the beneficiary moneys to which the beneficiary has become entitled, as against the trustee, when there is a subsisting account and the depositary has due notice that the beneficiary has acquired a right to make demand thereon; or through actual knowledge of an abuse of the credit, and a connivance, active or passive, in that abuse.

But there seems to be no ground upon which it can be required to exceed or depart from the usual course of business between depositary and depositor, for the purpose of discovering an abuse of the credit, unless circumstances are such that any reasonable person would believe that wrong was being done to the beneficiaries. In such a case it may be bound, not because it is a depositary, but like any and every person subject to the law, to abstain from wrongdoing, either by act or tacit consent.

An excellent illustration of the circumstances under which a

bank is so charged with knowledge of fraud as to act at its own risk is afforded by the case of Ihl v. the Bank of St. Joseph,[1] decided in 1887 by the Kansas City Court of Appeals. In that case it appeared that the plaintiff, Ihl, wishing to give security to those who had become his bondsmen, deposited with one Frenger, as receiving teller of the defendant bank, certain drafts for collection, with instructions that the proceeds be credited to Frenger's account—but whether to Frenger as trustee, or to Frenger simply in his own name, was not ascertained when the case came up on appeal. The drafts were collected and the proceeds credited to Frenger in his own name, and not to him as trustee. On the day on which the credit was given to Frenger he drew out the entire amount and converted it to his own use. There was no evidence of collusion between Frenger and the bank, as represented by its other officials, or that the bank profited by the misappropriation. Some time after, with the consent of his sureties, for whose indemnity the deposit was made, Ihl, the plaintiff, demanded the amount from the bank, which refused payment.

The court, after observing that it was conceded that the bank had credited the proceeds to Frenger's private account, went on to say that if the plaintiff directed this to be done, then (to quote the exact language of the decision), "there was no liability on the part of the defendant, unless it was bound in law, under the facts of this case, not only to credit the proceeds of the drafts, when collected in the manner directed by the plaintiff, but also to see to the proper appropriation of the proceeds of the draft by the person to whose account they were thus credited," and then continued as follows:

"We do not understand that any such obligation was imposed upon the bank by law, under the facts of this case. Frenger was the bank's teller, and knew of the terms on which, and the objects for which, the deposit was made. But, in so far as concerns the carrying out of the terms of the trust agreement between him and the plaintiff, he was acting simply for the parties to the agreement, and not at all within the scope of his agency or official duty as an officer of the bank. His knowledge was not the knowledge of the bank, either as to the terms of the trust agreement or as to his inten-

[1] 25 Mo. App. 129, 140.

ing the money out of the bank. . . . Besides, if the
, credited the proceeds of the drafts to the individual
renger, Frenger had the right, as against the bank, to
ıey out of the bank for the purpose of misappropriating
he bank knew of such purpose. This is true, because
not justified in refusing to honor the depositor's check
nows or believes that the check is an appropriation of
erson, or for a purpose, to whom, or for which, the
ot lawfully authorized to appropriate those funds. For,
should look into this matter he would make himself,
party to an inquiry between his customer and a third

t, after quoting the above passage from Morse on Banks and Banking, continues: "The author, in that connection, however, adds: 'But if the depositor seeks to pay his own debt to the banker by the appropriation of funds, to his credit in a fiduciary capacity with the banker, then the banker is affected with knowledge of the unlawful character of the appropriation, and would be compelled to refund.'"[2]

The court further said that whether the drafts were given to Frenger as teller, or not, "when the bank received the drafts, through him, for collection, he acted for the bank, and the knowledge had by him as to the proper disposition to make of the proceeds of the drafts was the bank's knowledge, because it pertained to a matter within the scope of his official duty, and as to which he acted officially." And it was concluded that if Ihl, the plaintiff, directed that the proceeds of the drafts be credited to Frenger's individual account, the bank was not liable; but that if he directed that they be credited to Frenger as trustee, then the bank was liable.

The foregoing decision seems to be a very accurate exposition of the grounds of a depositary's liability in regard to the disposal of trust funds on deposit, and of the extent of its duty concerning such disposal. In brief, a bank has ordinarily no duty to observe, or right to interfere, with the disposal of payments made to the depositor, or any right to refuse payment of checks duly drawn on deposit accounts, any more than other debtors have a right to refuse

[1] Quoting Morse on Banks and Banking, Sec. 317.

[2] Morse on Banks and Banking, Sec. 317.

payment to a creditor or to concern themselves with the disposal of the money when the debt is paid.

The only distinctions in case of trust deposits would seem to be that where a bank has actual knowledge that a breach of trust is intended, it would be chargeable with loss occasioned by its connivance in the breach, and that in such a case it would be the right and the duty of the bank to refuse to pay the moneys for the unlawful purpose.

There apparently is no principle of law requiring a depositary to go out of the usual course of business to detect the possibility or probability of a misappropriation of funds represented by checks drawn upon the depositor. If there were, it would be necessary for a depositary, before paying any check drawn by a trustee, to inquire into the circumstances under which the check was drawn, and to learn the consideration for the check and the intended or probable application of the proceeds.

It may be well, before closing, to mention one peculiarity of the statute law, which may seem to have some bearing on the matter now under discussion, so far as trust companies are concerned. In New York and New Jersey, at least, trust companies are specially authorized "to receive deposit of trust moneys, securities, and other personal property."[1]

Why trust moneys? Without discussing this question at length, it seems safe to conclude that the express power to receive such deposits is conferred upon trust companies in order that there may be no doubt that trustees, in depositing with them, will be protected in the event of unsuspected insolvency.

For the foregoing reasons, among others, it would seem that a depositary may properly receive and act upon a power of attorney from a trustee authorizing another, as attorney, to draw checks upon the account of the trust estate; provided, however, that the instrument creating the trust, or the decree appointing the trustee, has not forbidden him to act by attorney in that particular.

In conclusion, let me caution you to see that this power to delegate authority is not denied to the person executing the power of attorney, should you ever be called upon to consider such an instrument purporting to be the act of a trustee.

[1] New York Banking Law, Sec. 156; New Jersey P. L. 1899, p. 453.

DUTIES OF TRUSTEES OF FINANCIAL CORPORATIONS

ADDRESS DELIVERED BY WILLIS S. PAINE, EX-PRESIDENT OF THE CONSOLIDATED NATIONAL BANK OF NEW YORK, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT RICHMOND, VA., OCTOBER, 1900.

It is a remarkable fact that while the largest trust companies of the United States are located in the city of New York, such institutions were not examined by the superintendent of the Banking Department until the year 1874. Indeed, previous to that time there were no general laws applicable to such corporations. All trust, loan, mortgage, security, guarantee, or indemnity companies or associations were operated under the provisions of their respective charters. Some of these charters required reports to be made to the Supreme Court, others to the Comptroller of the State. It was not until the year mentioned that these corporations were placed under the supervision of the Banking Department and required to make full reports in writing to it, verified by the oaths of the officers of such corporations, and containing such statements as to the condition of their affairs and business as the superintendent might require. Under the law which I have mentioned the superintendent was required to examine such corporations personally, or to appoint competent persons to make the same, to the end that inquiry be made as to the condition of these corporations, the manner of managing their affairs, as well as the security afforded to those by whom its engagements were held.

Perhaps it is not irrelevant to state that during the first examination the examiners, of which the speaker was one, reported the condition of three of the trust companies located in the city of New York to the bank superintendent, and those corporations ceased doing business. Fortunately the depositors of these institutions, to whom there was owing over six million dollars, were paid in full. During the year 1875 two examiners, appointed by the Banking Department, of which the speaker also was one, found the trust companies in a materially improved condition by reason of recommendations made by the department to such corporations during the preceding year.

Experience has shown that seldom has a trust company failed whose last published statement has not indicated a large surplus

fund or undivided profits. The reason is that its trustees have not had the moral courage to charge off bad debts as soon as their collection is shown to be practically impossible. One thought ought always to be borne in mind—that the possession of ample cash or its equivalent is a sign of prudent banking. While the interest upon idle capital may be wholly lost, a trust company that is never embarrassed by an unexpected demand for money from its creditors, and which is always prepared to aid its depositors, must obtain a highly desirable prestige.

Trustees should not rely upon the researches of examiners rather than their own investigations. Between the visits of the examiners there may be large embezzlements or misapplications, and in the limited time afforded them it is oftentimes impossible to discover wrong-doing, especially in cases of collusion between several employees. If trustees were all well informed as to their duties and performed them thoroughly, failures would be exceedingly rare. The examinations should be without notice, and be for the condition of the institution at the close of business of a particular day, the examination commencing either after the close of business of that day or before the commencement of business of the next business day, thereby giving no opportunity for manipulation of the accounts, or borrowing assets for the occasion, and a constant watchfulness should be observed that this is not done during the examination.

The statement of a trust company to the Bank Superintendent of the State of New York is in the following form:

RESOURCES

Bonds and mortgages.

Stock investments.

Amount loaned on collaterals.

Amount loaned on personal securities, including bills purchased.

Overdrafts.

Due from directors of the institution.

Due from banks.

Due from brokers.

Real estate.

Cash on deposit in banks or other moneyed institutions.

Cash on hand.

Amount of assets not included under any of the above heads (accrued interest receivable, etc.).

LIABILITIES

Capital stock paid in.

Surplus fund.

Undivided profits.

Deposits in trust.

General deposits by individuals, associations, and corporations, payable on demand.

Other liabilities not included under any of the above heads, (accrued interest payable, etc.).

Every trust company should have a by-law requiring its board of trustees to appoint an examining committee at least once in six months, whose duty it should be to make a general examination of its affairs, not only to count the cash on hand, but, what is of much greater importance, to examine into the amounts stated to be due from various sources, and to compare its liabilities and resources with the balance on the general ledger. The details of the books tributary to the general ledger should be examined and footed, and the balances compared with the balance representing the account in the general ledger. Failure to compare the amount due depositors as shown by the individual ledger with that account in the general ledger, has been a serious omission in many cases, and thereby defalcations of years' standing have remained undiscovered. The items which make up the cash on hand in the drawer of the institution should be carefully scrutinized, a fictitious item sometimes being taken out at the time of the examination and sent for collection, to be returned worthless after the examination is over. The original credits for items said to be in transit and the letter-press copies of the letters remitting the same should be examined, and their receipt and payment or non-payment ascertained by correspondence. Indeed, correspondence should be had with every bank and trust company for verification of amounts alleged to be due from or to it.

The general ledger should represent the true condition of the company; yet there are many cases where it has not shown such condition. A case in point is that of a prominent institution which suffered a serious loss. In this instance the general ledger showed a much smaller amount due depositors than the individual ledger, certain amounts deposited not having been entered in the cash-book, but appropriated by the employee taking certain deposits and mak-

ing the entries direct on the individual ledger, the pass-book and ledger agreeing. This state of affairs would be revealed by comparisons as before indicated, and shows the error of the common supposition that if the pass-books and ledger agree, nothing further is requisite, as far as such accounts are concerned. After these necessary verifications of the accounts in detail with the accounts in the general ledger, the books being in balance in every particular, there yet may be concealed some irregularity; for instance, where an officer of an institution charged a large sum to profit and loss, crediting the same to bills receivable, the authority for which could not be shown, nor the bills receivable produced. All entries to the profit and loss account, and the classifications of the profit and loss account, such as interest, commissions, expenses, etc., should be examined and their validity tested. So many adjudications have been made from time to time that trustees have their duties plainly defined. If, for instance, notice of illegal transactions is brought to their knowledge, and the same are allowed to continue, they may be compelled to make good any deficiency caused by such illegality. While it is true that the higher qualities of banking, the skillful management of its affairs, are of much greater importance than the constant scrutiny into details, each may be valueless without the other. A constant inquiry should be made as to the conduct and habits of all the employees of the company.

In conclusion: The custodian of the property of others should welcome the most careful inquiry as to the condition of his trust, that the result may inure to his credit, confirming the fact that integrity and ability are necessary adjuncts to the capital of a financial institution, co-ordinate with the capital itself.

ESSENTIALS REQUIRED BY TRUST COMPANIES TO BE PUT IN MORTGAGES AND OTHER PAPERS

ADDRESS DELIVERED BY ANDREW SQUIRE, OF CLEVELAND, OHIO, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT RICHMOND, VA., OCTOBER, 1900.

WITHIN the last twenty years trust companies have increased very rapidly, and probably within the next twenty years will increase in numbers still faster. In many of the states, as in the state of

Ohio where I reside, they are of comparatively recent origin, the statutes, until within the last few years, not permitting corporations to be organized to act as trustees along sufficiently broad lines to induce their incorporation. As a rule, they have been so successful and so well managed that they are fast coming to be recognized as one of the great conservative forces in every community where established.

The field which is open to the trust company has not yet been fully determined. Almost every year adds to its usefulness. While it may be true that large estates and large trusts may occasionally be better managed by some individual peculiarly adapted to the purpose, it is equally true that the average management of estates and other large trusts by trust companies is better than the average individual management; and the individual management is liable at any time to be terminated by the death of the individual, while the management by a trust company should be continuous until the end of any ordinary trust.

Thus far there have been relatively few failures among trust companies, and it is exceedingly important that they should be surrounded at all times with that careful and judicious control and management which the law demands of trustees under all circumstances, and no trust of any character should ever be accepted by a trust company, in the fierce competition of business, upon terms which will not insure the bringing to the management of such trust all of the care and fidelity required for its proper execution. It is probably a safe statement to make that the majority of trustees are underpaid rather than overpaid for services rendered, and trusts are frequently undertaken that appear plain and simple which, before their termination, involve a large amount of labor and continuous care and anxiety.

Experience has shown that in acting as trustee under mortgages securing bonds there are certain essentials which should invariably be insisted upon by the trust company for its own protection. It is not unlikely that, as our experience becomes greater, it may be found proper and convenient to insist upon others; but it is the object of this paper briefly to call attention to those essentials which are being insisted upon by careful advisers of trust companies.

It is not the purpose here to refer to the trust company in any

sense as a promoter of any enterprise, or as agent to dispose of any bonds which may be secured by a mortgage making the trust company trustee; for the trust company as a promoter and as a seller of bonds occupies a different and distinct position from that which it occupies as a mere trustee.

As a trustee it is of first importance that the trust company shall not permit, in any mortgage or other instrument creating it a trustee, any representation as to the character of security or the priority of the lien which may be in any sense misleading. Care should be taken by the person examining the mortgage, if it be a mortgage, and the bond which it purports to secure, to see that the provisions are plain and thoroughly within the comprehension of the ordinary purchaser of bonds, who, it may be presumed, is less acquainted with such instruments and the provisions which they should contain than the examiner for the trustee; and when the trustee is called upon to certify a bond secured by a mortgage or trust deed, such certification, it should be thoroughly understood, is merely for the purpose of identification—that is, to identify the bond as one of the bonds described in the trust deed or mortgage given for the purpose of securing them. For a time, one saw, and even occasionally now, sees, a certification something like this upon the bond: "It is hereby certified that this bond is one of the series of bonds secured by the mortgage or deed of trust within mentioned." The use of the word "secured" in this connection has brought some trust companies which inaptly used it into litigation, for the reason that it was claimed that there was some force to the word "secured," and that the trust company's certificate certified that there was actually some security for the bondholders, when in reality there was no such security, prior mortgages being sufficient in amount to exhaust the property. In one instance suit was brought against a trustee using similar phraseology, when the trustee had failed to record the mortgage and a subsequent mortgage was recorded which exhausted the property. Happily in this instance for the trustee, the court, after holding the trustee should be responsible, found the action had been barred by the statute of limitations. Careful trust companies now confine themselves, in making such certificates, to a mere identification of the bond by phraseology substantially as follows: "It is hereby cer-

tified that this bond is one of the series of bonds described in the mortgage or deed of trust within mentioned."

The trust company, as trustee, in accepting the trust not only has the right, but it is its duty, to insist upon the instrument containing such provisions as will limit its liability and its duties within proper lines. These limitations are frequently found scattered in various places through the mortgage, in various phraseology, and covering various conditions, dependent largely upon the skill, experience, and care of the draughtsman. No trust company should get into the habit of accepting trusts of any character without the advice of its counsel, unless its own officers are thoroughly well acquainted with the conditions which such instruments should contain, and even then it is better to have all instruments submitted to some lawyer in active practice, especially accustomed to papers of that description. With many trust companies in the East, and with several in the West, it has become a habit, and unquestionably a good one, to place the conditions upon which the trust is accepted all together, immediately preceding the article of defeasance frequently placed at the conclusion of the mortgage or deed of trust. I know of no better way of placing concisely before you my views upon the essentials required in a mortgage or deed of trust than to give a substantial copy of the conditions which are now being recommended to trust companies:

Article.—The trustee hereby accepts the trusts and assumes the duties hereby created and imposed upon, and only upon, the following terms and conditions, to wit:

First.—The recitals of fact herein contained, and contained in the bonds issued under the authority hereof, shall be taken as statements made by the mortgageor, and shall not be construed as made by the trustee; and the trustee shall have no responsibility as to the validity of this mortgage, nor as to the execution or acknowledgment thereof, nor as to the amount or adequacy of the security herein provided.

Second. It shall be no part of the duty of the trustee to record or file these presents as a mortgage of real or personal property, or to refile, or renew the same, or do any other act for the continuance of the lien of this indenture, or to give notice of the existence of the lien hereof, or to extend or supplement the lien sought to be created hereby; nor shall it be any part of the duty of the trustee to effect insurance against fire or other damage to any portion of the property hereby mortgaged, or to renew any policies of fire or other insurance, or to keep itself informed or advised as to the payment of rents, taxes, or assessments of or upon the mortgaged premises and property, or to require the payment of such rents, taxes, or assessments; but the mortgageor shall and will perform all acts above mentioned necessary to fully

protect the bonds described herein. The trustee may, however, in its discretion, at the expense of the mortgageor, do any or all of the matters and things in this paragraph set forth, or procure the same to be done.

Third. The trustee may select and employ in and about said trusts and duties suitable agents and attorneys, whose reasonable compensation shall be paid by the mortgageor, or in default of such payment, shall be a charge upon the hereby mortgaged property and its proceeds paramount to said bonds, and the trustee shall not be liable for any neglect, omissions, or wrong-doing of any such agents or attorneys, reasonable care being exercised in their selection; nor shall it be otherwise answerable, save for its own wilful negligence and default.

Fourth. The trustee shall have a lien upon the mortgaged premises and the proceeds thereof prior and paramount to the bonds issued hereunder for its compensation, reasonable expenses, and counsel fees, incurred in the performance of said trust powers and duties, or any of them, and the mortgageor agrees to pay the same, and the holder of each bond issued hereunder assents to such priority of lien.

Fifth. The trustee shall be under no obligation or duty to perform any act hereunder, or to defend any suit in respect hereof, unless first idemnified to its satisfaction; nor shall the trustee be bound to recognize any person as a bondholder unless his bonds are submitted to the trustee for inspection, if required, and his title satisfactorily established, if disputed.

Sixth. The exclusive right of action hereunder shall be vested in the trustee until the refusal of the trustee so to act, and no bondholder shall have a right to enforce these presents, or to bring any action for that purpose, until after demand made upon the trustee, accompanied by a tender of indemnity satisfactory to it, and refusal of the trustee to act in accordance with said demand.

With reference to No. 1, which provides that the trustee is not bound by the recitals of fact contained in the mortgage or in the bonds, while that provision is properly inserted, still a trust company should not rely upon it to permit any obvious mis-statements in either of the instruments referred to. They should be critically and carefully examined and, after that is done, the trust company protected by some clause substantially like the one given above.

The second paragraph, as read, is by no means an invariable provision, because some mortgages or trust deeds do not include any insurable property, or do not include property from which it is necessary to collect rents. In all cases the paragraph should be modified to meet the exact situation of the case. Certain it is that no trust company, for the ordinary compensation, frequently fixed at one dollar per bond or less, should think of accepting the responsibility of seeing that any chattel mortgage is properly recorded or filed, or kept recorded or filed, in accordance with the various statutes of the

different states where property is liable to be located, or to look after the collection of rents, or to take the responsibility of placing and keeping insurance upon the property covered by the mortgage. A trust company may assume these duties, all or any of them, but, in the event it does so, such duties should be assumed understandingly, and compensation commensurate with the increased burdens and liabilities should be allowed.

As to the fifth paragraph, which provides for indemnity to the trustee before it is obliged to act under the mortgage or defend any suit in respect thereof, the necessity and importance of such indemnity are clearly obvious, and work no hardship upon bondholders entitled to demand action on the part of the trustee. The fifth paragraph also provides that the trustee is not bound to recognize any person as a bondholder unless his bonds are submitted to the trustee for inspection and his title satisfactorily established, if disputed. Circumstances have arisen when parties who were not the rightful owners of bonds have made demands upon the trustee, and the trustee has occasionally been placed in an embarrassing position because of such demands, and not having the right under the mortgage to require a production of the bonds and satisfactory evidence of title. It is the safe rule to have the trust company in a position to require of anyone claiming to be a bondholder the production of the bonds he claims to own for inspection by the trustee, and, if ownership is disputed, to have it satisfactorily established.

The last paragraph, providing that the exclusive right of action be vested in the trustee until it refuses to act, presupposes absolute impartiality on the part of the trustee. It frequently happens in practice, especially with respect to large properties, that various reorganization committees are instituted; some in the interests of majority and minority stockholders, others in the interests of majority and minority bondholders. Frequently officers of the trust company which is trustee may act as members of these reorganization committees; sometimes of more than one of them; and sometimes the trust company itself may even be the holder of bonds. But the trust company, as trustee, should always, in good faith, act in any litigation solely in its capacity as trustee, and when so acting, clothed with the right to act primarily, it is able to prevent much vexatious litigation, sometimes brought by separate and individual bondholders

for delay and personal advantage. Cases do occur in which, over the proceeds of property or possibly over the property itself, controversies arise among bondholders of such a character that the trustee should step aside and let the bondholders settle their own differences; but cases of this kind are exceedingly rare, and instruments should be so drawn as to protect, through the trustee, every individual bondholder upon precisely the same footing, the trustee being an agent for that purpose, and clothed with full power to control all necessary litigation.

Other provisions might be mentioned which are useful, but it has been the aim to name simply those things which may fairly be considered essential for the trust company to insist upon in accepting a trust under a mortgage. Some mortgages provide for a majority, or two-thirds, or three-fourths of the bondholders controlling the action of the trustee in various matters, especially in declaring the principal of the bonds due on default, and requiring the trustee to begin and carry on or discontinue foreclosure proceedings under the mortgage. Such provisions are really of more interest to the bondholders than to the trustee, but it is an entirely reasonable provision to have inserted in the mortgage that some majority of the bonds should be able to control the maturity of the bonds in the event of default, and should have a voice in directing all litigation and proceedings brought by the trustee. Also the rights of the mortgageor and the interests of the various people holding stock in the mortgageor, if it be a corporation, must not be lost sight of by the trustee.

Essentials required by trust companies to be placed in instruments other than mortgages depend upon the character of the trust created. The only safe rule is to have every such instrument prepared or approved by counsel. Provisions which will enable a trust company to have its accounts regularly audited and settled with someone authorized to act on the part of the beneficiaries are useful, so that the trustee may be free to devote its entire attention to carrying out the wishes of the party creating the trust, with the knowledge that its conduct and administration of the trust will never be questioned after having made its regular settlements. It should be the uniform principle of a trust company, with all the essentials guarded and protected, so to conserve and handle every trust, and at such moderate and reasonable compensation, that the profit to the trust company

will come from the regular and increasing business earned by its record.

THE PROPER CONSERVATIVE ATTITUDE OF TRUST COMPANIES TOWARD CORPORATE ENTERPRISES

ADDRESS DELIVERED BY JOHN E. BOURNE, PRESIDENT OF THE COLONIAL TRUST COMPANY, NEW YORK, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT RICHMOND, VA., OCTOBER, 1900.

TRUST companies have had for years relationships with certain corporate enterprises; they have acted as trustees in railroad and other corporation mortgages; as transfer agents and registrars of stocks issued by such corporations; and have performed various functions which, being purely clerical and administrative, call for no discretion in attitude or relationship, which latter consists largely of a proper performance of certain duties. The great industrial development, however, of the past few, and particularly the last two, years has created another field of usefulness and activity for trust companies, and their services have been made use of in bringing into existence certain large corporate enterprises, in some instances new and in other, by far the greater number, the result of the consolidating and joining together of already existing firms and companies. Here the trust company may act as intermediary in various ways: it may become the depositary of stocks and bonds, titles and equities of corporations and firms; the holder of purchase moneys and payer of the same, the collector of subscription moneys and issuer of new securities, under agreements of consolidation; and it performs the various and varying functions incident to each particular case.

Being thus brought into close contact with an organization, it becomes associated in the public mind with its formation, and its relationship with the enterprise is considered an indorsement of the good faith and probity of the organizers of the same. It is therefore of the utmost importance that a trust company should in every case thoroughly satisfy itself on these points, and that it should decline any business connection where these are at all

doubtful; otherwise it will lay itself open to future criticism and will be bound to suffer in standing. No business function should be entertained where the least cloud exists.

A trust company should take the same view of a corporate enterprise that a merchant takes of a customer. The shrewd merchant first satisfies himself of the standing, both financial and moral, of the applicant for his merchandise, and if he is satisfied on both points, he gives him commensurate credit; if he is not satisfied on either of the above points, he will either refuse to open business connections, or will at any rate limit them to a strictly cash basis. The trust company must take the same view of corporate enterprises. If their financial and moral standing is excellent, it can afford to lend them its credit; if it is not so, it should not even deal with them, as the merchant does, on a cash basis; it will save itself embarrassment and criticism by not establishing business connections with them. Being thoroughly satisfied, however, it can serve a corporation in many ways: it can act as its reference (and the reference of a trust company goes a very long way and has a decided influence in the public mind, hence the necessity of being most careful in this direction); it can bring it into contact with capitalists, and it can further its interests legitimately in various directions without in any way becoming sponsor of its ultimate business success. With this it should not concern itself, and it should in no sense ever become the exploiter of any business or the guarantor in any way of its future success. Where any other course is adopted, the very laws of chance will make a trust company at some time or other sponsor for one enterprise out of many that will fail of success or prove disappointing, and this will reflect more seriously on it, and hurt its general standing and reputation more than it has been benefited by the success of the many. Therefore it should not become the exploiter of a corporation's future possible success. This should be made very clear by a thoroughly neutral attitude. A trust company should practically say to the public: "We know the originators of this enterprise; we are satisfied with their ability, responsibility, honesty, and good intentions; as to the possibility of profit in the business, however, that every investor must look into for himself."

The recent industrial movement has brought to the front or-

ganizers and promoters of many classes. The responsible, serious one is readily known as such by his affiliations. The irresponsible, obscure one makes up in assurance what he lacks in the more desirable requisites; he secures his clientele by representing himself as more important than he is; he endeavors to secure the co-operation of a trust company by a generosity in prospective which has behind it the ulterior motive of using the company for the purpose of giving him a fictitious credit and standing. I have no doubt all of you are familiar with this character. He has no objection to any charge you propose on an issue of bonds, and considers any figures you may give him for the performance of prospective services perfectly satisfactory. He makes with you a tentative arrangement, which, as he possesses no responsibility, is rather one-sided at best, and then you find him using your name freely as being behind him and his particular enterprise. His methods of ingratiation are various, but they have all one purpose, and only one result with regard to yourselves. He is to be shunned.

It therefore seems to me that the proper conservatism of attitude of a trust company toward a corporate institution lies in assuring itself always of the standing of its originators; in not entering into business relationship with other than responsible, respectable parties; in assisting such parties by vouching for them where their standing is assured; and in taking no part in exploiting the profit-earning side of any enterprise. By assuming this course it will carry out the functions which fall to it logically in the present era of industrial development, namely, that of facilitating the formation of reputable corporations. Here, in order to retain the confidence of the public, its functions should end.

In conclusion, permit me to say that in preparing this article I do so with the knowledge that the business of trust companies in various portions of the United States differs materially, and that what may be looked upon as proper functions in one section of the Union may be considered as either too conservative or not conservative enough in some other section. I have the hope, however, that the above conclusions will be acquiesced in by the majority of my brothers in active trust-company service. It seems to me that the position of a trust company must be like that of Cæsar's wife—above suspicion; it should in itself represent the highest form of

commercial and financial credit, and it can do this only by keeping free from entangling alliances which may provoke criticism and injure its standing in the community of finance.

THE BENEFIT OF A REAL ESTATE DEPARTMENT TO A TRUST COMPANY

ADDRESS DELIVERED BY LORENZO E. ANDERSON, VICE-PRESIDENT OF THE MERCANTILE TRUST COMPANY OF ST. LOUIS, BEFORE THE AMERICAN BANKERS' ASSOCIATION AT WASHINGTON, D. C., OCTOBER 10, 1905.

THE trust company in many states of the Union, on account of its liberal charter, is authorized not only to do a general banking business, but also to do everything or anything else where bonds, stocks, mortgages, or real estate enter into or are part of the transaction; and, from my observation, very few transactions of any magnitude are negotiated without real estate being one of its important factors. Take one of the most important departments of a trust company, namely the trust department. I say "most important," because it is the department where trust in its truest sense should be exemplified, as it has the management of estates for widows and orphans, and it frequently happens that the largest portion of such estates consist of real estate. Then it is that the real-estate department is of inestimable value to the trust company, as every well-equipped real-estate department should have experienced appraisers, salesmen, and rent collectors, of whose integrity and ability there is no question, and the company thus avoids the necessity of seeking outside assistance in the management of the real property belonging to such an estate. It is through the real-estate department, in a majority of cases, that it is possible for the trust department to secure the management of such estates, because when a person makes his will, and is possessed of considerable means, his first consideration is to name as executor of his estate some individual or corporation in whom he has the greatest confidence, and the fact that the trust company has managed his real-estate affairs satisfactorily and successfully during his life-time. and is thoroughly familiar with all the details of his property, in-

fluences him to a great extent in selecting such company to handle his estate after his death.

The financial departmnet of the trust company is benefited in many ways by the real-estate department. For instance, when money is easy and the financial department has a surplus of idle cash on hand, the real-estate department can be called on to procure for its investments in the form of real-estate loans; and as these loans are made only on a conservative basis, after the property has been inspected by men experienced in that line, and approved by the officers in charge of the real-estate department, they can again be disposed of through that department without any difficulty, in case it becomes necessary or desirable to do so.

The real-estate department is also the medium through which the financial department secures a number of depositors. Take the case of an individual whose property is sold through the real-estate department. He comes into the office to close up the transaction, and the consideration is paid to him in cash, or part cash, and the remainder by deed of trust and notes. It is frequently only necessary to make the suggestion to him that he open an account with the company with the proceeds of the transaction, and it is very seldom that one will leave the office without doing so. It is not an uncommon occurrence in the real-estate department for a buyer to make the cash payment on a real-estate deal by a check drawn on the company, and for the seller to open an account with the company by depositing the same check, the company thereby making a commission on the sale of the real estate and securing a new depositor on the same transaction.

If, however, the person desires to convert the proceeds of a real-estate sale into an investment other than real estate, he is referred to the bond department, where he will undoubtedly invest the money in securities which that department offers. Thus the bond department is provided with a new client, who, if it were not for his dealings with the real-estate department, might never have transacted business of any character with the company. The deposits of a successful real-estate department are in themselves a considerable item, if it has a large rent roll.

In 90 per cent. of all real-estate transactions only a part of the consideration is actually paid in cash, the balance being secured

by deed of trust and notes on the property sold. The seller, therefore, after the sale has been consummated, has on hand a number of valuable papers, which he will desire to place in a safe repository, and as the safe-deposit department of the company is so convenient, he is certain to rent a safe-deposit box from that department. As the notes become due they are placed with the collection department and the proceeds deposited to his account. In this manner the customer is enabled to transact all the details of a real-estate deal with one company, making it convenient for him and profitable for the company.

Then again a large number of people have occasion to visit the real-estate department. Some of them come in to rent a house, others to pay rent or purchase property, and some to inquire about real estate. Many of them may not transact any business at the time, but there is a possibility of each person becoming a customer at a later date, by reason of his remembering his former visit. Again, if one takes into consideration its value from an advertising standpoint, one can readily see how beneficial it is to an institution to have a great many people constantly entering and leaving its building.

The trust company is also benefited from an advertising standpoint by continually keeping the name of the company before the public, through the medium of the newspapers, sign-boards, and rentbills which are scattered throughout the city. In the case of the Mercantile Trust Company (I mention this company because of my knowledge of its affairs), one cannot visit any portion of the city of St. Louis without seeing its name on some sign announcing property for sale or lease, and every day in the year its name will be found in the newspaper for a like purpose. It is needless for me to comment on the advantages of such extensive publicity, as it brings the company in touch with every man, woman, and child in the community who may sometimes have occasion to transact business with a trust company.

It may not be out of place here to say that the real-estate department, besides being advantageous to the company of which it is a part, contributes in a manner to the prosperity of the city in which it is located, by promoting syndicates for the conducting of large real-estate enterprises. The real-estate department of the

company with which I am connected has organized corporations and promoted deals aggregating millions of dollars. For all of these corporations it simply acted as agent, not being interested in any of them as a stockholder. In other words, in the promotion of the syndicates the real-estate department, or the trust company, has no direct interest whatever in the corporations, apart from acting as agent for the sale of property owned by them for collecting rents on the same, or performing the duties of manager of construction of office buildings or commercial structures being erected by the syndicate, for which services it receives commissions and fees. In addition to this, it has the placing of insurance, letting of repairs, and payment of taxes on all such buildings, making it necessary to handle large sums of money and transact business with a great many people; and as a result of these dealings a large portion of these individuals subsequently become regular patrons of the institution.

In the affairs of a community the real-estate agent ranks next in business importance to the banker. Real estate from time immemorial has been the foundation of all values, and has furnished more business for different lines of trade than any other commodity. The iron foundries, brick manufacturers, lumber merchants, certain professions, and all mechanics are prosperous when the real-estate business is good. The real-estate agent is the herald of progress, the maker of villages, towns, and cities, and his efforts mark the advancement and progress of municipalities; and any trust company is indeed fortunate to have among its departments a well-equipped and properly conducted real-estate department.

In order to be valuable, a real-estate department must be progressive—must be competent to cope with and carry to successful issue the enterprises and deals of any magnitude. To do this, it must necessarily attract capitalists and capital seeking this avenue of investment; and it is a well-known fact that many of the most prosperous citizens of large cities invest only in real estate. Real estate is the investment which is sought by many who have made their money in other channels, and who, desiring to convert their funds into an investment which they know to be safe and which will net them a good return, naturally turn their thoughts to real estate. The trust company, by reason of its prominence and re-

liability, having attracted their attention, it is through it that they make investments of this character, if the company has a real-estate department, and it thus secures a class of investors it would not otherwise have obtained.

In summing up the advantages accruing to the trust company from a real-estate department, I would say that it not only benefits all other departments, but is in itself profitable. As an individual department, the real-estate department of the Mercantile Trust Company is operated as a separate and distinct branch—that is, it pays for all its own advertising, pays the salaries of the officers of the trust company who have charge of the department, as well as of all the employees connected with the department, and defrays all the other expenses incurred in the conduct of the department. It also makes a monthly statement to the company, at the same time turning over to it the net results of the month's business, which, in the case of the institution with which I am associated, has always been of such a satisfactory nature that I am inclined to believe that the real-estate department is one of its most valuable assets, as it is not only unnecessary for the company to invest any of its capital in any of the transactions of that department, but that it is self-sustaining and profitable. In my opinion, no trust company is complete without a real-estate department, because the object of a trust company should be to take care of everything that comes its way. In other words, it should let nothing escape that may result in a commission or a fee; and it is my firm belief that a company is not in a position to do this unless it has a real-estate department as one of its departments. Therefore, I unhesitatingly say that every trust company should have a real-estate department, if for no other reason than that it will pay, if properly conducted.

THE SAVING DEPARTMENT OF A TRUST COMPANY

ADDRESS DELIVERED BY THORNTON COOKE, TREASURER OF THE FIDELITY TRUST COMPANY OF KANSAS CITY, MO., BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT ST. LOUIS, OCTOBER, 1906.

ONE of the interesting features of American finance in this generation has been the development of trust companies. The trust company has assumed the varied duties of many separate institutions, and of different persons. It performs the functions of a commercial bank, the real estate agent, and the fiscal agent. It acts as trustee, guardian, curator, executor, administrator, receiver and attorney; so doing many things formerly undertaken only by individual business men and by lawyers. Trust companies frequently have savings departments, and these are generally considered identical with independent savings banks. Forms, methods, and results are indeed nearly equivalent, but there are differences, and we can well spend a few minutes in comparing the organization, investments, reserves and rules of trust company savings departments with those of savings banks.

A word upon some of the advantages of trust company savings departments may precede the comparison. Like other economic aggregations of the time, trust companies are remarkable for economy. They facilitate the transaction of business between what would formerly have been separate business houses, lawyers and banks. They concentrate under a single administration the resources of many classes of clients, depositors, legatees, wards, and those who trust, utilizing these resources to the fullest extent, and so deriving the maximum of profit from the entire clientele. The contribution of one department to the general assets of the company may be a modest one, but each department enjoys the advantage inherent in large resources, and the advantage of the company's administrative skill.

The savings deposits of a trust company can be invested with economy and to great advantage, and the savings department is a constant feeder to the other departments.

The organization of a savings department in an old or a new trust company is a matter of no difficulty, and at first additional help is not usually needed. The forms adopted will be those in use in savings banks, and should be selected from the compilation of this

section. In small companies one teller will be able to attend to the counter business of all departments, and there will be no confusion if the savings deposit and withdrawal forms are on paper of different color from the forms used by the banking and trust companies. After the business has grown somewhat, the task of consulting the ledger and the signature files as customers withdraw funds will interfere with the teller's attention to patrons with checking accounts, and the bookkeeper can verify signatures and balances for him. In one company that had not as yet felt the need of a separate paying teller for the savings department the bookkeeper entered withdrawals in the pass-books, and returned them to the customers, whom he referred to the paying teller for their money. At the same time he initiated the withdrawal tickets and dispatched them to the paying teller on a trolley, such as is used for carrying change between salesman and cashier in mercantile establishments. The teller had only to pay to the holders of pass-books the cash indicated by the tickets with corresponding numbers. The arrangement was satisfactory, but with the further growth of the business separate tellers and bookkeepers were, of course, required, and the commercial and the savings departments now come into contact only as cash is interchanged between them, and on the general books of the company.

Trust companies do not ordinarily make separate investments for their savings departments, but, of course, the investing officers have an eye always to the amount of savings deposits. Ordinarily, such deposits are the most stable of all, and in case of excitement among savings depositors, there is the right of requiring a reasonable notice before making payments. It may, perhaps, be the policy of a company to invest its commercial deposits largely in business paper, and to hold a liberal supply of high grade bonds, easily converted into cash should the commercial depositors require their funds in advance of the maturities of the business paper held by the bank. Of the savings deposits, however, a large proportion should be invested in real estate mortgages, which will bear a higher rate of interest than bonds, and the volume of which can be maintained more even than the volume of commercial paper.

Trust companies are not under the same restrictions as to investments as are savings banks. There is a savings bank law in Missouri, but no bank operates under it. Restrictions on investments

are so severe as to be impracticable. The Missouri trust companies, however, carry savings deposits of more than $20,000,000. Severe restrictions are not necessary for trust companies. The latter are institutions with capital, and errors of judgment by the investing officers can always be made up out of the capital, leaving the depositors protected. I recall only one or two serious failures of trust companies. Most of the savings banks, however, those holding $2,736,000,000 of the $3,093,000,000 deposits reported by the Comptroller of the Currency, however reliable these figures may be, are mutual institutions, and any unfortunate investment directly affects the depositors. The more liberal provisions for investments have induced trust companies to provide the facilities of savings banks in localities where savings banks proper could not have lived.

The reserves of trust companies are much larger than those of savings banks. According to the last report of the Comptroller of the Currency, the proportion of cash and sight exchange to deposits in the savings banks of the country was 6 per cent., and in the trust companies 18 per cent. The difference, of course, is due to the difference in the character of the businesses. While no trust companies, so far as I know, apportion their reserves among their departments, the reserves are generally fixed by their officers on the supposition that the savings deposits are steady in character, and do not require the same provision that must be made for the checking or commercial accounts. The laws of many states are framed on this theory. In some companies, however, a different policy obtains. It is feared that if a panic should ever develop among the savings depositors, it would be persistent, and would result in the withdrawal of a large proportion of the savings deposits. Accordingly, some companies carry heavy reserves against their savings deposits in the form of quiet accounts with other banks, which they expect not to use except to meet panic demands.

These companies would not expect to apply the rule giving them the right to require a certain notice of the intention of the depositor to withdraw his funds. This rule is universal in the savings business, whether in the savings bank or in the savings departments of trust companies, and some banks always apply it as a matter of principle. It enables them to say definitely just what their requirements will be thirty or sixty days hence, and enables them to invest more

closely than is otherwise possible, because all the requirements are known, and they have no reserves to keep against uncertainties. Trust companies, however, fear the effect of the enforcement of the notice rule. It could easily create alarm among savings depositors that would be communicated to checking depositors, and it might cause a run that would destroy a bank business built up by half a lifetime of skillful and conscientious labor. If the rule were applied always, as it is in many savings banks, its enforcement would require constant explanation to all classes of depositors, and might be misconstrued by them. The checking customer might not be able to rid himself of the impression that the enforcement of the rule was occasioned by a continuous shortage in the company's supply of cash, and many such an one would be inclined to transfer his account to a bank. Many, knowing the existence of such a rule would never open their accounts with a trust company in the first place.

The question of applying the rule even in case of a run, is by no means simple. At first thought it seems like advertising to depositors with checking accounts that the company is short of cash to meet the demands upon it. It is the experience of some companies, however, in case of a run beginning in the savings department, that checking customers have early withdrawn their balances, fearing that the entire available resources of the company would be used in paying off savings depositors. Such customers have sometimes redeposited immediately upon the application of the notice rule to savings accounts, and many trust company officers believe it well at the first sign of a run in the savings department to apply the rule, so assuring checking depositors that their cash requirements for legitimate business will have precedence over the unreasoning demands of frightened savings depositors.

It is open to question whether savings depositors are really more liable to fright than are checking depositors. In the nature of things there can be no statistics upon the question. The former are, on the average, less educated than are the latter. Many of them are children and irresponsible youths. Perhaps they take fright more easily than men and women with checking accounts. You recall the run on the Pullman Loan and Savings Bank last month, because the cashier requested an Italian workman to provide identification,

and the run on the Hibernia Savings and Loan Society of San Francisco, for which no reason whatever could be found. Once frightened, however, there is little to choose between the man with the savings book and the man with the check book.

The whole question of investments and reserves for the savings department of a trust company depends upon the company's peculiar circumstances. The officers of the company will have regard to the considerations just outlined, to the character of the patrons of all departments of the company, to the economic and sociological conditions of its territory, and to the strength and disposition of its correspondents.

Trust companies advertise far more widely than do savings banks, and the transaction of savings business by mail is practically confined to the former. It would be interesting to know how the trust company and the savings bank fare in direct competition for savings deposits. Unfortunately statistics are at this point only fragmentary. There is no report of the total savings deposits in trust companies. Deposits of all kinds in trust companies were reported last year by the Comptroller of the Currency to be $2,164,000,000. Savings deposits in savings banks were nearly $1,000,000,000 more. We, of the trust companies, shall not force you out of business yet awhile.

The trust company has been successful as a savings bank, and successful in general largely because it has undertaken this function. The customers of the savings department have found their way into all the departments. Some have become patrons of the bond or investment department, but not many, because most of them have been saving for homes or to go to school, or to go into business. Some have found their way into the safe deposit department to put away the title and papers, and the insurance policies on the homes their savings have bought. Very many have left the savings department for the checking department, as their savings have enabled them to begin some little business. With the prestige of large capital, and of large business in other departments, trust companies have developed the savings business and fostered the savings habit where neither had been known to any extent before, and the officers of trust companies, gentlemen, are proud to claim their share with you in the development of thrift and financial independence in the American citizen.

THE ADVANTAGE OF OPERATING SAFE-DEPOSIT VAULTS IN CONNECTION WITH THE TRUST COMPANY

ADDRESS DELIVERED BY WILLIAM A. CARR, SECRETARY AND TREASURER OF THE UNION SAFE DEPOSIT COMPANY, PITTSBURG, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT RICHMOND, VA., OCTOBER, 1900.

THE trend of the times in business life is toward combination, the bringing of all auxiliary lines around a main business. The "department store," so arranged and furnished as to enable the purchaser to make all his purchases under one roof, and to save him time and annoyance in using his credit in a number of business houses, is a striking illustration. The same principle operated in the "department store" applies and with equal advantage to a "trust company."

The strictly up-to-date trust company under its corporate power, is given an opportunity to make itself indispensable to large classes of a community inside and outside of the business world. It can avail itself of this opportunity, as the department store does, by grouping around its main business all its auxiliary lines of business under the direction of bright, progressive managers.

Some trust companies make a specialty of a particular work and give no attention to the department policy; but these companies are not following the trend of the times, as we have earlier seen it to be. In a well-organized trust company there are departments, and of various kinds. These departments are needed for the convenience of the customer, will be appreciated by him, and will tend to fix him in the permanent list of customers. One of these departments popular with the customer and, we may add, profitable to the company, is the safe-deposit department. As an illustration: A customer of the banking department desires to purchase bonds. His relations with the banking department have been satisfactorily and fully established. He is introduced to the manager of the bond department, and, dealing with him, he makes selection and purchase of certain bonds. It happens, however, as is often the case, that, for convenience in making deliveries or sales, he desires to have a safe place in which to deposit his bonds, instead of registering them. The bond department manager, learning his wish and need, now introduces him to the manager of the safe-deposit department. The plan of

boxes in that department is submitted, and he makes a selection suitable to his requirements. Then, upon his signing a contract for the use of his box, the key thereof is delivered to him, and his bonds are deposited therein.

There is, we admit, little direct profit in the safe-deposit department when run on a small scale, but the indirect profit of keeping your customer in the house may be considerable. And while the box rent may be small, a fair profit will likely accrue from the sale of the bonds.

The fundamental principle in business is in keeping your customer—making him feel satisfied that you are doing the best that can be done for his interests under all the circumstances. When once he has favored you with his patronage, if you have the departments needed to accommodate his requirements, and in each of such departments his interests are carefully handled, he will remain with you, and the net results of his business, running through the various departments accommodating him, will likely be important.

There are many women customers in these times, and their number is constantly increasing. They especially prefer to have their safe-deposit boxes with the company that transacts their trust or banking business. They can deposit their coupons, notes, collaterals, or other securities in the banking department for collection, and thereby save time, risk, and the inconvenience that attends transacting business at several places. The guard of the safe-deposit department should be particular in his attention to the ladies, saving them as much trouble as possible. He should see that their boxes are carefully inserted in the proper space in the safe-deposit vault, and when removed, carry them to the coupon rooms. These little attentions are gratefully received, and not only do much toward making the renters of boxes feel that their patronage is appreciated, but lead them to tell their friends, and so to become active agents for the company in soliciting new business. The manager of one of the large trust companies in New York recently said that they had many renters, both men and women, having no one to assist them in their money matters, who would frequently have the guard in charge help them cut their coupons and arrange them in envelopes for deposit in the banking department of that company.

The first safe-deposit company in the city of Pittsburg was or-

ganized in the year 1867. Since that time there have been at least ten additional ones established, including banks which rent boxes.

As to the style of locks for safe-deposit boxes, it is very desirable to have double locks with two escutcheons. Many of the renters suppose, when the guard places his key in the same escutcheon they use, that he has access to the boxes. This is a mistake, and the impression should be avoided as far as possible. The guards and managers of the safe-deposit department should be careful to see that the renters properly replace their boxes in their own compartment.

As to general powers of attorney granting admission to safe-deposit boxes, they should specifically set forth that the attorney in fact has authority to open the box; for, while some companies consider a general power of attorney sufficient authority, others insist that a specific power be given granting that privilege.

The advertising for the safe-deposit department should be kept up continuously, and should be of a rich, neat, and attractive character. Of course, you do not get immediate results from your advertising. It is like the farmer sowing his seed; he has to wait until the seed finally develops into the crop, and this means that he will reap his harvest perhaps a year afterward. This law applies as well to the advertising of the safe-deposit department and of all the other departments of a large trust company. One of the prominent merchants of Philadelphia, at one time having occasion to increase his credit, sent his credit man to New York to see Mr. A. T. Stewart concerning the granting of a larger line. The credit man admitted that the profits made by his concern were not sufficient for the amount of business done, and upon this admission the additional credit was declined. The principal of the house then went to New York to obtain if possible the desired credit, meeting with the same result. Later he requested a personal interview with Mr. Stewart who at first also declined to grant him further credit; but when, upon considering his claim, Mr. Stewart asked him: "How much money did you pay for advertising last year?" and received the answer, "Ninety-four thousand dollars" Mr. Stewart said: "Add this to your profit for last year and it shows you a very handsome return." As the result of this new light on the situation Mr. Stewart said: "You can have the additional credit.

You will not begin to realize until this year the benefit from the money you paid last year for advertising." This is true of trust company advertising. A great deal of missionary work is done from which no returns are received for one, two, and in some cases three years. But by careful, judicious, and persistent advertising fair results are sure to come, if you have facilities for taking care of the business, and if you treat your customers politely and handle their business with care.

The safe-deposit department should be made as attractive as possible. Some of these places are very dismal looking. Last summer when in London I visited one which was so gloomy that it reminded me very much of a dungeon, with its heavy grates and bars and its dim lights. The largest safe-deposit department I have ever seen is that in connection with the Crédit Lyonnais in Paris, this one department covering four floors. It is four stories under ground, all the different entrances are carefully guarded, and all the renters are carefully examined as they pass in. The safe-deposit boxes are in large cupboards, and each of these cupboards in turn has a variety of assorted boxes, so that it is impossible to get into more than one compartment at a time.

In ordering safe-deposit boxes for a company it is difficult to decide on the sizes to place in the vault, as the demand varies. The proper way is to buy them in sections and sort them up to suit the demand.

One of the most successful novelties which we use in advertising our safe-deposit department is a small tin box in which renters can collect their diamonds, jewelery, etc., and place in their safe-deposit box. We have sent out 2,500 of them and have met with the best results

TRUST COMPANY ADVERTISING

ADDRESS DELIVERED BY RICHARD L. CRAMPTON, ASSISTANT CASHIER, NATIONAL BANK OF THE REPUBLIC, CHICAGO, BEFORE THE AMERICAN BANKERS' ASSOCIATION, AT RICHMOND, VA., OCTOBER, 1900.

OCCASIONALLY one finds a man who says that it is not good business ethics for trust companies to advertise. The average man will admit they may advertise. The officers of most companies, I believe, think they should advertise. The signs of the times say they must advertise—that is, if increasing dividends are desired. By advertising I mean the broader definition—all that goes to make favorable publicity.

Many of the older trust companies have established reputations in their respective cities which keep on bringing new business to them three hundred and sixty-five days in the year, but even they must let the growing generations of this advertising age know that an up-to-date business is still being done at the old stand. The newer trust companies, particularly those in the West, where the functions of a trust company are only beginning to be understood, must make an advertising investment for the business of ten or twenty years in the future.

Perhaps in no business can good advertising be considered as favorably in the light of an investment as by trust companies doing the usual estate business. The estate of a person who to-day is favorably impressed with the stability and business policy of a trust company sufficiently to name it as executor and trustee in his will may not become a trust for many years, and while the results are a long way off, the companies which are making the best impression upon the public to-day through their advertising will later on, other things being equal, reach greater results than those which do not advertise.

The question, then, is as to the best methods of advertising. This will always be a matter of opinion. One man holds tenaciously to a style which another regards altogether wasteful, if not absolutely injurious. Someone has said that advertising is one of the modern wonders. The established principles are certainly of a very general character, and the secrets are hard to discover.

Each company should have someone, preferably an officer, to attend to all advertising matters, at least so far as relates to the

general policy, in order that he may be brought to study more carefully the latest methods of reaching the people. I say "preferably an officer" for the reason that I believe it will greatly promote the best interests of the company to have someone in authority who appreciates the importance of the subject, understands the policy of the institution, and is on an equal footing with those whom he can consult with greater advantage than can an employee or an outside advertiser.

The duty of creating new business is certainly of as great importance as, and more difficult than, merely executing the business in hand, and should receive corresponding attention. I have been unable to learn of a single instance where professional advertisers, not familiar with trust company business, have been able to give satisfactory results unaided. I can see no reason for this except that their point of view has been greatly biased by their experience in handling advertising to sell goods. Trust companies do not have goods to sell. They simply are giving publicity to their stability, their methods, and their terms. In all of this the personal equation is the largest factor. It is, then, largely a matter of impressing the public favorably with the personality of the management, without seeming to do so.

The public knows an institution through its advertising. Therefore it should be absolutely of the best. If the person in charge of it is unfamiliar with the subject, he will do well to call in one of the best advertisers he can find as an assistant, expecting to pay him well for his services. But I believe it is necessary, in order to obtain good results, to study the situation independently, and in a large measure to act independently of his advice. First of all study the constituency carefully and its point of view. Different localities and different constituencies require very different methods. If it is expected to get the money back that is invested in advertising, with a fair percentage in addition, it is essential that the details of the matter receive such careful attention that they may be considered as being almost on a scientific basis. Better not advertise if you cannot do this.

Each company has one or two strong talking points, or at least it should have. The company with which I have the good fortune to be connected has probably one of the best boards of directors

of any similar institutions.[1] It is composed of well-known, leading business men, who are active in the interests of the company. Naturally prominence is given to this fact in our advertising. It is also well known that our policy is progressively conservative; hence we are careful not to do anything to disabuse the public of this opinion. If we had a fine building of our own, we certainly should let the public know it, as such a building is undoubtedly a good investment from an advertising point of view, implying, as it does, permanence.

I am more and more impressed with the fact that we are best advertised by our "loving friends," and that no expenditure can bring as good results as that which will secure the class of officers and employees who will make a favorable impression upon the public with whom they come in contact. Disregard of the attentions properly due a customer, or one who may be asking for information, costs an institution a great deal more than the time which should have been expended. This is particularly true of financial business; and yet how often one notices want of courtesy on the part of those connected with such institutions!

The most common form of advertising is through the publication of the quarterly statements called for by the state authorities. It is surprising that so many of these statements are so cheaply gotten up. If an excuse for advertising is necessary, certainly here is the excuse, and it should be worked for all it is worth. At least once a year the statement should be issued in an especially attractive booklet form and made to cover fully all the features of the business.

Booklet advertising is very desirable for trust companies, and should receive careful attention. Let the cover design be done by the best artist obtainable, in a simple, strong, and direct style, embodying, if possible, some distinctive marks which may become known as belonging to the company, using it as a sort of trademark. Good designs cost money and are worth it. The same can be said of good paper and printing. Make everything about a booklet as good as the gold you are trying to get in trust, and I believe it will pay.

[1]At the time of this address Mr. Crampton was with the Northern Trust Company of Chicago.

The most important contribution to trust company literature is Mr. Breckinridge Jones's paper on "The Trust Company Question," which has been used extensively all over the country and must have brought results when printed properly. It is difficult to understand how some of the companies which printed Mr. Jones's paper, in the poorest manner possible could have expected to make a favorable impression and get any returns.

Every trust company should issue at least one fine booklet, covering in detail the different features of the business which it transacts. This can be supplemented by smaller and less extensive booklets on the different features taken separately. For example, one on "Acting as Trustee under Wills," others on "Trust Agreements for the Management of Property," "Estates of Minors and Incompetent Persons," "Registration and Transfer of Capital Stock of Corporations," "Relating to the Appointment of a Corporate Trustee under Mortgages to Secure Bond Issues," and under other titles which will suggest themselves. If banking, surety, title, or safe-deposit departments are conducted by the company, each should have its separate literature, all preferably in the same uniform and distinctive style. To get the best results from such direct advertising matter requires a carefully prepared mailing-list. The names and addresses should be placed on cards showing the business connection, standing, etc., of each individual, and with a place for noting the advertising sent out from time to time. Mail the general booklet with a carefully worded personal letter, and if any inquiries result, note the fact on the address card and send the particular booklet which fits the case. If no results are obtained in a reasonable time, a letter of reminder will not be out of the way. If the party is making his will, the result of the advertising may not be known until his death, years later.

Remember always that cheap, careless, and sensational advertising unconsciously impresses the recipient with the idea that the company using it has the same characteristics.

Many trust companies favor the use of novelties, such as letter-openers, pocket-books, etc., the value of which, considering their large cost, I believe is greatly overestimated. Frequently I have asked persons who had such advertising souvenirs if they knew the name of the firm on them, and the answer has been very often in the

negative, although the name had been before their eyes every day. If such things can have some relation to the trust business, and be presented in a very personal way with attractive printed matter, their value is greatly increased.

About three years ago I wished to increase the business of our safety vaults, which were not doing well, and hit upon the idea of sending out handsomely lithographed metal boxes, one-quarter the size of a safety box. In these I inclosed a will envelope and some advertising matter suggesting that valuable papers be put in the box and returned to the vault for safe-keeping. The details of the scheme were carefully worked out, with the result that we got our money back several times over the first year and are still getting results, making it necessary greatly to increase the number of boxes in our vaults. The idea has been adopted by a large number of other companies. Several of these, however, say they have not had as much success as we did. Perhaps some details were omitted which were essential, or the local condition may have been different.

This year, to advertise our general business, which includes a banking department, we issued a new form of daily memorandum calendar with different reading-matter for nearly every day. This gave a splendid opportunity for going into the details of our business and of keeping our name promptly before the users. These were sent principally to attorneys—who, by the way, can do more to influence trust business than almost any other class of people. Another trust company in Chicago issues each year for attorneys a very convenient pocket diary in which information concerning the courts is printed. Another company gets out a pocket directory of attorneys with telephone numbers and court rules. Things of this kind can be of great service, as they come into daily use.

Newspaper advertising is valuable, and one is tempted to act upon the principle that, if a little is desirable, a large amount will bring proportionate results; or, if it is a good thing to advertise once a week, it will be seven times better and quicker to advertise daily. If this reasoning is followed, the advertising appropriation will soon equal the income account. I believe it is better to treat this class of advertising as part of the necessary auxiliary methods, and to use relatively small spaces, say, once or twice a week. In some localities it may be advantageous as an educator to use reading-matter in

the news columns, in order that the public may come to know and fully appreciate the functions of trust companies, and it would seem well that companies in the newer fields divide the expense of such publicity.

I will say, in closing: Beware of the numerous schemes, special editions, programs, and things of this character which are so frequently presented, are of no special value, and are a considerable expense in the aggregate. Better leave them alone entirely. Remember to plan your advertising in advance if possible, and not leave it to be done on the spur of the moment. Also that trust-company advertising must have something in it which is more than mere cleverness, and that you must at all times have a clear understanding of the point of view of the possible client and follow the lines of least resistance.

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